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BEFORE THE ARIZONA CORPORATION COMMISSION

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ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-04204A-06-0783
UNS ELECTRIC, INC. FOR THE)
ESTABLISHMENT OF JUST AND)
REASONABLE RATES AND CHARGES)
DESIGNED TO REALIZE A REASONABLE)
RATE OF RETURN ON THE FAIR VALUE OF)
THE PROPERTIES OF UNS ELECTRIC, INC.)
DEVOTED TO ITS OPERATIONS)
THROUGHOUT THE STATE OF ARIZONA)
AND REQUEST FOR APPROVAL OF)
RELATED FINANCING.)

**REPLY POST-HEARING BRIEF
OF UNS ELECTRIC, INC.**

Arizona Corporation Commission
DOCKETED
NOV 19 2007

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November 19, 2007

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1 UNS Electric, Inc. (“UNS Electric” or “Company”) through undersigned counsel, hereby
2 submits its Reply Brief in support of the relief it seeks in this docket.

3 UNS Electric has proposed necessary and innovative measures to address its significant
4 financial and operational challenges in providing reliable and safe electric service to customers at
5 reasonable rates. At the same time it is facing substantial growth in its service area, the Company
6 also must replace its entire power supply portfolio and refinance all of its long-term debt. As a
7 result of these unique and demanding circumstances, the relief sought by UNS Electric is critical
8 for the Company to be able to maintain its financial integrity, to continue to have access to capital
9 on reasonable terms and to acquire a diverse and economic power supply portfolio. Any
10 degradation of the company’s financial position will result in increased costs and higher rates in
11 the long run.

12 Staff and RUCO, unfortunately, recommend denying much of what the Company seeks. In
13 doing so, both parties adhere to traditional ratemaking principles without considering the unique
14 circumstances that UNS Electric faces and the undisputed evidence in this case. Although Staff’s
15 and RUCO’s opposition is often a summary assertion that the Company has not met its burden of
16 proof, the Company has, in fact, provided substantial and undisputed evidence – and more than
17 met its burden of proof – justifying: (1) Construction Work in Progress (“CWIP”) in rate base; (2)
18 full recovery of its operating expenses, including payroll expense, incentive compensation, and
19 rate case expense; (3) an authorized return on equity of 11.80 percent; (4) a fair rate of return on
20 Fair Value Rate Base that comports with Arizona law; (5) mandatory time-of-use, inverted block
21 rate design and rate consolidation; (6) a Purchased Power and Fuel Adjustment Clause (“PPFAC”)
22 that provides full and timely recovery of all costs associated with procuring fuel and purchased
23 power; and (7) necessary rate base treatment and rate reclassification for the Black Mountain
24 Generation Station (“BMGS”) that will allow the Company to acquire the asset as part of its new
25 power supply portfolio.

26 Without approval of its requests in this docket, UNS Electric will have no choice but to file
27 another rate case in very short order. And it will lose a unique opportunity to acquire an important

1 generation asset that would help to diversify its power portfolio. UNS Electric urges the
2 Commission to grant the full relief UNS Electric requests in this case.

3 UNS Electric's Initial Post-Hearing Brief anticipated and addressed many of the arguments
4 the other parties raised in their opening briefs. This Reply Brief focuses on key issues relating to
5 UNS Electric's ability to effectively address the demands it faces in its service area. For all issues,
6 UNS Electric maintains its position as set forth in its Initial Post-Hearing Brief.

7 **I. UNS ELECTRIC'S REVENUE REQUIREMENT.**

8 **A. Rate Base Issues.**

9 The Company stands by its position on all rate base issues discussed in its Initial Post-
10 Hearing Brief. The evidence shows UNS Electric's Original Cost Rate Base ("OCRB") to be
11 \$141,036,562 and its Fair Value Rate Base ("FVRB") to be \$177,847,579. The Company further
12 incorporates all its arguments from its Initial Post-Hearing Brief and will not repeat all of those
13 arguments here. Rather, the Company will focus on (1) CWIP; (2) Accumulated Depreciation; and
14 (3) Accumulated Deferred Income Taxes.

15 **1. The evidence fully justifies inclusion of CWIP to protect and preserve**
16 **UNS Electric's financial integrity.**

17 In requesting the inclusion of CWIP in rate base, UNS Electric presented compelling and
18 uncontroverted evidence about the unique and exceptional financial circumstances that the
19 Company is facing. First, UNS Electric has experienced unprecedented growth in its service
20 territory requiring the Company to expend millions of dollars to ensure safe and reliable service.
21 Second, that growth does not pay for itself; rather it creates an annually recurring revenue
22 deficiency of \$4.8 million. Third, the Company has no base load generation and its current full
23 requirements power contract expires in May 2008, requiring the Company to spend millions of
24 dollars more to acquire replacement power. And, fourth, within the next twelve months, the
25 Company will have to refinance all of its long-term debt, in the amount of \$60 million. These are
26 extraordinary and unique circumstances that even Staff witness Ralph Smith has acknowledged
27

1 have not occurred for a utility in Arizona before.¹

2 However, in response, neither Staff nor RUCO take these unprecedented circumstances
3 into account. Although neither party refutes the facts underlying UNS Electric's need for CWIP in
4 rate base, both parties continue to argue general rate making principles that simply do not
5 recognize the gravity of the situation facing UNS Electric. And though both Staff and RUCO
6 acknowledge that allowing CWIP in rate base may be appropriate in certain circumstances, both
7 continue to rely on vague standards and summarily conclude that UNS Electric has simply not met
8 the standard. For example, Staff continues to assert that UNS Electric must be in "financial
9 distress" before CWIP should be allowed in rate base. Staff's undefined "financial distress" is not
10 a standard that has been or should be embraced by this Commission. By waiting until a company
11 is in financial distress, the damage already will have been done through higher costs of capital,
12 increased costs of power supply due to insufficient credit support and potentially delayed
13 infrastructure improvements due to lack of access to sufficient capital. Rather, the Commission
14 should look to maintain the financial integrity of the Company to ensure that it will continue to
15 have access to capital on reasonable terms and will be able to procure power supply resources at
16 reasonable costs.

17 The unrefuted evidence in the record presents compelling reason to include CWIP in rate
18 base. UNS Electric witness Mr. Kentton Grant provided extensive evidence about how the
19 Company has faced, and will face, continued high growth in its service territory.² The Company's
20 growth in net plant investment was 68.6 percent from 2004 to 2006; APS, by contrast, experienced
21 only 28.9 percent growth over this same period.³ So, the Company must raise large sums of money
22 to fund necessary plant growth.⁴ The evidence is that, from 2005 to 2009, the Company projects
23 its capitalization to grow from \$115 million to \$212 million.⁵ Net plant leads to additional fixed
24 costs, and growth is driving capital requirements far in excess of the Company's internal cash

25 ¹ Tr. (R. Smith) at 1207.

26 ² Ex. UNSE-35 (Grant Rebuttal) at Ex. KCG-10 and KCG-11.

27 ³ Ex. UNSE-35 (Grant Rebuttal) at 16.

⁴ Ex. UNSE-35 (Grant Rebuttal) at 16.

⁵ Ex. UNSE-34 (Grant Direct) at 27, Ex. KCG-9.

1 flow.⁶ The Company's financial integrity erodes because of higher capital costs associated with
2 larger capital outlays. Further, net cash flow as a percentage of capital expenditures was 51
3 percent less than the industry average.⁷ Finally, Mr. Grant also provided evidence that new growth
4 in the twelve months following the test year caused a \$4.8 million annual revenue deficiency.⁸

5 The Company also presented unrefuted evidence that it must significantly improve its cash
6 flow and that it needs CWIP in rate base to meet that need. As Mr. Grant testified, annual cash
7 flow after capital expenditures fell from negative \$447,000 in 2004 to negative \$9,414,000 in 2005
8 – and is expected to drop precipitously to negative \$31,131,000 in 2007.⁹ The Company would
9 have a speculative grade credit rating if it was rated.¹⁰ UNS Electric must refinance all \$60
10 million of its long-term debt in August of 2008. And the Company must replace its entire power
11 supply by June of 2008. Adding CWIP in rate base would add \$2.1 million in additional annual
12 revenues.¹¹ CWIP in rate base is necessary for UNS Electric to preserve its financial integrity by
13 improving its cash flow and earnings and to enable the Company to meet the extraordinary
14 financial circumstances it is facing.

15 Although its discussion of CWIP is minimal, Staff makes several assertions that ignore the
16 record. First, Staff generally asserts, at page 5 of its Post-Hearing Brief, that CWIP can result in a
17 mismatch, particularly if the CWIP produces additional revenue related to growth. However, Staff
18 (and RUCO) fail to acknowledge that a large portion of the CWIP is non-revenue producing, non-
19 expense reducing plant – even though Staff acknowledged that fact on the record. UNS Electric's
20 Initial Post-Hearing Brief, at page 11, lines 6 to 16, sets forth the record evidence that
21 approximately \$5.6 million of CWIP avoids Staff's asserted mismatch problem. Additionally,
22 even if the remaining \$5.2 million of test year CWIP projects are indeed revenue producing, the
23 evidence is clear that the incremental revenues generated by plant investment are dwarfed by the
24

25 ⁶ Ex. UNSE-35 (Grant Rebuttal) at 13.

26 ⁷ Ex. UNSE-35 (Grant Rebuttal) at Ex. KCG-12, page 2.

27 ⁸ Ex. UNSE-35 (Grant Rebuttal) at Ex. KCG-10, page 2.

⁹ Ex. UNSE-34 (Grant Direct) at 4.

¹⁰ Ex. UNSE-34 (Grant Direct) at 5.

¹¹ Ex. UNSE-34 (Grant Direct) at 27.

1 increase in fixed costs borne by UNS Electric (i.e. the annually recurring revenue deficiency of
2 \$4.8 million). If there is any "mismatch" that the Commission should be concerned about, it is the
3 mismatch between costs and revenues that is occurring year after year at UNS Electric as a result
4 of growth, and not a mismatch that is purported to have occurred in a test year that is already 17
5 months old.

6 Second, Staff incorrectly infers, at page 5, line 21 of its Post-Hearing Brief, that the
7 Company will receive a return on its CWIP through Allowance for Funds Used During
8 Construction ("AFUDC"). In fact, without CWIP in rate base, UNS Electric will continue to
9 experience a large revenue deficiency on the CWIP balance. As shown in Attachment 2 to UNS
10 Electric's Initial Brief, \$8.7 million out of the \$10.8 million in the CWIP balance is already in
11 service and the Company is no longer accruing AFUDC on that amount.

12 Third, Staff asserts, at page 6 of its Post-Hearing Brief, that UNS Electric is viewed as low
13 risk by ratings agencies and does not need CWIP because it can attract capital based on the credit
14 quality of its parent. However, Staff's position is flawed because it (i) is based on an out-dated
15 rating agency report issued when there were still 5 years left on the Pinnacle West contract and (ii)
16 fails to recognize that the UNS Electric's parent company has not issued any guarantee of UNS
17 Electric's obligations.¹² In fact, as set forth in detail at pages 41 through 44 of its Initial Brief,
18 UNS Electric is decidedly riskier than comparable companies.

19 Finally, the Commission's decisions regarding allowing CWIP for the Palo Verde Nuclear
20 Generating Station, in fact, support UNS Electric's request. In Decision No. 54247, the
21 Commission concluded that including CWIP is not contrary to rational and fair economic pricing
22 principles and that including moderate amounts of CWIP has "virtually no effect on the
23 apportionment of risk between shareholder and ratepayer."¹³ The Decision also noted that
24 including so-called short-term CWIP in rate base may be reasonable, and that the Commission had
25 in previous decisions, included CWIP largely as a means of addressing critical cash flow problems
26

27 ¹² UNSE-35 (Grant Rebuttal) at 26-27.

¹³ Decision No. 54247 (November 28, 1984) at 17-18.

1 for public service corporations or to prevent certain types of earnings attrition.¹⁴ And in allowing
2 Palo Verde CWIP in rate base, the Commission stated in Decision No. 54202 that “it would seem
3 postponing a small increase today in favor of an even larger one tomorrow will do [some
4 ratepayers] little good.”¹⁵ The Commission allowed \$260,000,000 Palo Verde CWIP in rate base,
5 in part, to *preserve* APS’ financial viability.¹⁶

6 The same rationale should be applied here based on the undisputed record. The Company
7 faces difficult and unique challenges. In addition to meeting the demands of high growth, UNS
8 Electric faces the prospect of having to refinance its long-term debt as well as procuring up to 450
9 MW capacity by June of 2008. Staff and RUCO ignore these critical facts when summarily
10 disallowing CWIP from rate base. However, including CWIP in rate base is critical in allowing
11 the Company to meet the rapid growth in its service area while supporting the Company’s
12 financial integrity *and* giving UNS Electric a reasonable opportunity to actually earn its authorized
13 rate of return (“ROR”).¹⁷

14 **2. The evidence supports the Company’s accumulated depreciation.**

15 Although the Company provided ample evidence in support of its accumulated
16 depreciation and Staff has not disputed the Company’s position, RUCO describes the Company’s
17 argument as “extensive rhetoric.” In addition to the record evidence supporting the Company’s
18 accumulated depreciation, the Company proved numerous errors in RUCO witness Rodney
19 Moore’s accumulated depreciation calculation. For instance, Mr. Moore uses a mid-year
20 convention that is *not* in accordance with the FERC Uniform System of Accounts (“USOA”).¹⁸
21 Instead, a mid-month convention is a more accurate convention to calculate accumulated
22 depreciation. Mr. Moore and RUCO also failed to consider salvage or removal costs associated
23 with assets retired from service.¹⁹ RUCO depreciates transportation equipment using the group

24 ¹⁴ Decision No. 54247 at 17 (FN 12), 18-19.

25 ¹⁵ Decision No. 54204 at 17.

26 ¹⁶ Decision No. 54204 at 17.

27 ¹⁷ Neither Staff nor RUCO addressed post-test year plant or CWIP-related advances. UNS Electric stands
by its Initial Post-Hearing Brief on those issues.

¹⁸ Ex. UNSE-12 (Kissinger Rebuttal) at 10; Ex. UNSE-13 (Kissinger Rejoinder) at 1; Ex. UNSE-37.

¹⁹ Ex. UNSE-12 (Kissinger Rebuttal) at 10.

1 method, when the unit method should have been used.²⁰ Finally, Exhibit UNSE-37 shows that Mr.
2 Moore used *the wrong depreciation rate* for certain classes of transportation equipment.²¹ These
3 fundamental errors in Mr. Moore's analysis explain the difference between the Company and
4 RUCO.

5 **3. RUCO's proposed adjustments to Accumulated Deferred Income Taxes**
6 **("ADIT") ignore the evidence and the Commission's Rules.**

7 RUCO argues that UNS Electric must follow the NARUC USOA in determining its ADIT.
8 However, Commission Rule A.A.C. R14-2-212.G.2 expressly directs electric utilities to use
9 FERC's USOA, which is *different* than NARUC's USOA. In particular, there is no Account 271
10 under FERC's USOA – which is the account that RUCO relies on under the NARUC USOA. The
11 Company is required to directly credit the related plant or CWIP; there is no separate account to
12 deduct from rate base.²² Decision No. 55774 (October 21, 1987) also allows utilities to create a
13 deferred tax asset and claim rate base treatment when using the self-pay method, which is exactly
14 what the Company did.²³ Further, regarding ADIT for Administrative and General ("A&G"), the
15 Company is proposing a *prospective* adjustment to A&G expense. But that does not affect the
16 amount of ADIT A&G already accumulated.²⁴ Staff has not disputed the Company's ADIT
17 (except to the extent it reflects CWIP in rate base – which is not RUCO's argument) and the
18 Commission should adopt UNS Electric's adjustment for ADIT.

19 **B. Operating Income.**

20 UNS Electric maintains its position on all Operating Income issues stated in its Initial Post-
21 Hearing Brief. UNS Electric's adjusted Operating Income for the test year is \$8,770,016. The
22 Company addressed most of its positions in its Initial Post-Hearing Brief and will not reiterate all
23 of those positions and arguments here. However, the Company specifically responds to a few key
24 issues regarding operating expenses below, including: (1) Payroll Expense; (2) Incentive

25 _____
26 ²⁰ Ex. UNSE-12 (Kissinger Rebuttal) at 10-11.

27 ²¹ Tr. (Moore) at 860-61, 867-68.

²² Ex. UNSE-13 (Kissinger Rejoinder) at 2.

²³ Ex. UNSE-12 (Kissinger Rebuttal) at 6-8.

²⁴ Ex. UNSE-12 (Kissinger Rebuttal) at 9.

1 Compensation, including the Performance Enhancement Plan, and the Supplemental Executive
2 Retirement Plan (3) Rate Case Expense; (4) Call Center Expenses; and (5) Other Expenses.

3 With respect to the determination of the Company's revenue requirement, the Commission
4 must provide recovery for the Company's operating expenses and capital costs. *Federal Power*
5 *Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1943). Under the Arizona Constitution, the
6 Commission is required "to allow a recovery for all reasonable expenses." *Tucson Electric Power*
7 *Co. v. Arizona Corp. Comm'n*, 132 Ariz. 240, 245, 645 P.2d 231, 236 (1982). Indeed, the
8 Commission must provide sufficient income to permit full recovery of "operating costs" in
9 addition to the return on rate base. *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 533-34, 578
10 P.2d 612, 614-15 (App. 1978). And a utility's expenses are presumed to be reasonable and
11 incurred in good faith. *West Ohio Gas Public Utility Comm'n of Ohio*, 294 U.S. 63, 72 (1935).
12 Once the utility established a prima facie case for the reasonableness of its operating expenses – by
13 showing actual incurrence – then the burden shifts to other parties to show by substantial and
14 competent *evidence* that the expenses are unreasonable by reason of inefficiency or bad faith.
15 *Boise Water Corp. v. Idaho Public Utilities Comm'n*, 555 P.2d 163 (Idaho 1976).

16 **1. Payroll Expense.**

17 The Company proposed two adjustments based on known and measurable changes
18 occurring after the test year ended – an approach Staff endorsed in the UNS Gas rate case (Docket
19 No. G-04204A-06-0463). First, the Company made a payroll adjustment to increase normalized
20 payroll by three percent effective January 2007, for existing employee levels during the test year.²⁵
21 This adjustment relates to then-current employees providing service to *existing* customers during
22 the test year.²⁶ Second, the Company proposed the same normalized overtime expense adjustment
23 method here as Staff endorsed in the UNS Gas rate case.²⁷

24 Staff has not addressed the payroll expense adjustment in its initial brief. RUCO
25 apparently disagrees with the payroll expense adjustment for the pay increase but has not

26 ²⁵ Ex. UNSE-25 (Dukes Rejoinder) at 11-12.

27 ²⁶ Ex. UNSE-25 (Dukes Rejoinder) at 11; Tr. (Moore) at 901-02.

²⁷ Ex. UNSE-24 (Dukes Rebuttal) at 20.

1 addressed the overtime adjustment. For the reasons set forth in the UNS Electric's initial brief, the
2 Company's payroll expense adjustment should be adopted.

3 **2. Incentive Compensation and Supplemental Executive Retirement Plan**
4 **("SERP")**

5 UNS Electric requests to recover \$251,566 of operating expenses for the Company's
6 Performance Enhancement Plan ("PEP"), Officer's Long-Term Incentive Program ("LTIP") and
7 SERP. No Party argued that any of these programs led to employees or officers being
8 overcompensated. The evidence is undisputed that the overall level of compensation is
9 reasonable.²⁸ Therefore, the Commission should not disallow any portion of these programs.

10 **a. Performance Enhancement Plan and Officers Long-Term**
11 **Incentive Program**

12 The standard on whether to allow recovery of these costs is whether the costs are
13 prudently-incurred, not who benefits from those costs. It could be argued that *all* costs benefit
14 both ratepayers and shareholders. But it would clearly be unlawful to only allow 50 percent of all
15 operating expenses in rates. The Commission should not rely on vague "equity principles" to
16 justify a sharing of prudently-incurred costs for some expense categories, but not others. *See*
17 *Citizens Utilities Board v. Illinois Commerce Comm'n*, 651 N.E.2d 1089 (Ill. 1995). Yet, that is
18 effectively what Staff recommends with regards to the PEP, without any evidence to substantiate a
19 50/50 sharing. RUCO's recommendation – to disallow all PEP expenses – is even more
20 egregious.

21 Staff's position is perplexing given that this Commission recently allowed Arizona Public
22 Service Company ("APS") to recover all cash-based incentive compensation.²⁹ UNS Electric's
23 PEP is similar to the APS program. The PEP consists of elements primarily intended to benefit
24 the customers and puts a portion of employees' total compensation at risk as a means to encourage
25 and enhance each employee's individual performance.³⁰ UNS Electric should be allowed full
26 recovery of its PEP program just like APS.

27 ²⁸ Ex. UNSE-24 (Dukes Rebuttal) at 6-7.

²⁹ Decision No. 69663 (June 28, 2007) at 36-37.

³⁰ Ex. UNSE-24 (Dukes Rebuttal) at 7-8.

1 Moreover, despite RUCO's assertion, at page 10 of its Closing Brief, that the test-year
2 incentive compensation was out of the ordinary, the evidence is clear that at-risk compensation is a
3 normal and recurring expense. The *only* reason a "Special Recognition Award ("SRA")" was
4 awarded in 2005 – versus PEP compensation – was due to an unplanned outage beyond the
5 employees' control.³¹ All other PEP goals for 2005 were achieved.³² The amount of the award per
6 the SRA was less than the PEP payout would have been to employees. RUCO does not dispute
7 that incentive compensation in general and the PEP in particular are necessary for UNS Electric to
8 attract and retain quality employees; if incentive compensation did not exist, the Company must
9 raise base compensation. PEP costs should be allowed in their entirety as the Company requests.

10 The Company's LTIP also provides direct benefits to customers and for the same reasons,
11 full recovery of LTIP expenses is justified.

12 **b. Supplemental Executive Retirement Plan.**

13 The Commission has allowed SERP expense in past cases when the overall compensation
14 package to executives is not found to be excessive.³³ The same is true in this case. SERP is a
15 reasonable operating expense and simply allows executives to be held harmless from the Internal
16 Revenue Code ("IRC") by allowing executives proportionally equivalent retirement benefits to all
17 other employees.³⁴ SERPs are offered by 93 percent of general industry companies and 96 percent
18 of energy/utility companies.³⁵ The Company must offer this program and stay competitive in
19 attracting and retaining quality executives, who provide a direct benefit to the customers.³⁶ And
20 here, the evidence is undisputed that the overall level of SERP expense is reasonable. The
21 Commission should adopt its previous standard and allow SERP expenses as reasonable and not
22 excessive.

23
24
25 ³¹ Ex. UNSE-24 (Dukes Rebuttal) at 29.

26 ³² Ex. UNSE-24 (Dukes Rebuttal) at 29.

27 ³³ Decision No. 64172 (October 30, 2001) at 15.

³⁴ Ex. UNSE-24 (Dukes Rebuttal) at 14-15.

³⁵ Ex. UNSE-25 (Dukes Rejoinder) at 9.

³⁶ Tr. (Moore) at 896.

1 **3. Rate Case Expense.**

2 UNS Electric requests \$600,000 in rate case expenses – to be amortized over three years.
3 This is only a portion of what UNS Electric will incur in litigating this rate case.³⁷ However, both
4 Staff and RUCO argue that \$600,000 is unreasonable based solely on the rate case expense
5 awarded for Southwest Gas Corporation in Decision No. 68487 (February 23, 2006). But, as set
6 forth in UNS Electric’s Initial Brief, there are material differences between Southwest Gas and
7 UNS Electric that render the comparison worthless. Southwest Gas has accounting, legal,
8 budgeting and other departments; UNS Electric does not.³⁸ Tucson Electric Power Company
9 (“TEP”) directly allocates costs to UNS Electric for service they actually use; Southwest Gas
10 charges its Arizona operations indirectly whether those services are used or not.³⁹ Southwest Gas
11 has internal personnel costs included in its base rates; UNS Electric does not.⁴⁰ Finally, UNS
12 Electric does not have the resources Southwest Gas has and must rely on outside services from
13 TEP and other vendors. RUCO witness Mr. Moore admits these key differences⁴¹, while Staff
14 simply fails to acknowledge them.

15 Moreover, this rate case involved significant issues that were not addressed in the SWG
16 rate case, including the Black Mountain Generating Station rate base treatment and the need for a
17 new PPFAC. The Company also faced substantially more discovery as a result.

18 Staff’s and RUCO’s reliance on a rate case expense “benchmark” determined in another
19 rate case that involved materially different circumstances is simply inappropriate. Rate case
20 expense is an expense very particular to individual utilities. Courts understand that rate case
21 expense is “highly specific to the particular utility and particular rate case in question” *City of*
22 *Lancaster (Sewer Fund) v. Pennsylvania Public Utility Comm’n*, 793 A.2d 978, 982-84 (Pa.
23 Cmwlth. 2002). Further, rate expense may be influenced by factors such as whether a utility has
24 an in-house legal staff, or is facing extensive amounts of discovery. *Id.* As long as actual rate case

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³⁷ Ex. UNSE-24 (Dukes Rebuttal) at 17.

26 ³⁸ Ex. UNSE-24 (Dukes Rebuttal) at 16.

27 ³⁹ Ex. UNSE-24 (Dukes Rebuttal) at 16.

⁴⁰ Ex. UNSE-24 (Dukes Rebuttal) at 16.

⁴¹ Ex. UNSE-39.

1 expenses are prudently-incurred, the Commission must allow recovery in rates. *Columbus*
2 *Telephone Co. v. Kansas Corp. Comm'n*, 75 P.3d 257 (Kan. 2003); *Butler Township Water Co. v.*
3 *Pennsylvania Public Utility Comm'n*, 473 A.2d 219, 221-22 (Pa. Cmwlth. 1984); *Maine Water Co.*
4 *v. Public Utilities Comm'n*, 482 A.2d 443, 453 (Me. 1984). Because UNS Electric's rate case
5 expenses are prudently incurred, the Commission must allow them in rates.

6 **4. Call Center Expense.**

7 RUCO attempts to challenge UNS Electric's Call Center by asserting a single – and
8 misconstrued – statistic concerning customer complaints should be the sole factor in deciding
9 whether call center consolidation was a cost-efficient measure. In fact, the previous system could
10 not handle the call volume that UNS Electric faces as its customer base continues to grow.⁴² UNS
11 Electric needed increased staffing and personnel and expanded facilities regardless of whether it
12 consolidated these operations with TEP.⁴³ UNS Electric's consolidation of its call center
13 operations with UNS Gas and TEP was simply the most cost-effective solution – and comported
14 with the increased efficiency through consolidation contemplated by the Commission in Decision
15 No. 66028. Staff also has not challenged the Call Center Expense, and the Commission allowed
16 similar Call Center expenses for UNS Gas. The Commission should allow recovery of this
17 expense.

18 **5. Other Expenses.**

19 Although RUCO challenges several smaller expenses, the Company substantiated the
20 legitimacy of these expenses through the testimony of Thomas J. Ferry, UNS Electric's Vice
21 President and General Manager. Mr. Ferry explained why the expenses at issue were directly-
22 related to providing service to customers.⁴⁴ In contrast, RUCO provides no detail specifically
23 meeting its burden to justify disallowing specific expenses. There is simply no basis to adopt
24 RUCO's recommended disallowance for other expenses.

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27 ⁴² Ex. UNSE-21 (Ferry Rebuttal) at 4-5.

⁴³ Ex. UNSE-21 (Ferry Rebuttal) at 4.

⁴⁴ Ex. UNSE-21 (Ferry Rebuttal) at 6-7.

1 **C. Cost of Capital**

2 **1. The Company's proposed Return on Equity accurately reflects the level**
3 **of risk faced by UNS Electric.**

4 UNS Electric requests a return on equity ("ROE") of 11.80 percent that reflects the specific
5 circumstances of UNS Electric and its commensurate level of risk. Staff and RUCO continue to
6 recommend ROEs of 10.00 percent and 9.30 percent respectively. These recommendations are 75
7 and 145 basis points below the 10.75% ROE that the Commission recently awarded to Arizona
8 Public Service Company, a much larger investment-grade company with diversified generation
9 resources.⁴⁵ The evidence in this case is undisputed that APS is less risky than UNS Electric.

10 Although Staff infers that UNS Electric witness Mr. Kentton Grant did not use widely-
11 accepted methodologies such as Discounted Cash Flow ("DCF") and the Capital Asset Pricing
12 Model ("CAPM") as part of his determination,⁴⁶ the record is clear that Mr. Grant provided
13 extensive analysis using both DCF and CAPM approaches. But Mr. Grant's analysis also reflects
14 the actual circumstances of UNS Electric, something that neither Staff nor RUCO factored into
15 their analyses. Looking at those circumstances, it is clear that UNS Electric is a relatively risky
16 investment compared to APS or the comparable companies group. None of the companies in the
17 comparable company group face the challenge of having to refinance all of their long-term debt
18 while at the same time replacing their entire power supply portfolio. All of the distribution utility
19 companies held by the comparable companies are larger in size and many have sizeable generation
20 assets. All of those companies have investment-grade credit ratings. UNS Electric faces high
21 growth that has adverse impacts on its financial integrity, amply shown through testimony,
22 exhibits and analysis. Finally, UNS Electric does not provide a dividend payment.⁴⁷ As a result, a
23 60 basis-point upward adjustment and an 11.80 percent return on equity is justified based the
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25 ⁴⁵ See Decision No. 69663 (June 28, 2007) at 49. (The Commission approved a 10.75 percent authorized
26 ROE for APS.)

27 ⁴⁶ For instance, Staff states "UNSE is requesting a cost of equity of 11.8%. Staff, on the other hand, relied
 upon three well-accepted methodologies in arriving at a range for cost of equity between 9.5% and
 10.5%, with a mid-point of 10.0%." See Staff's Post-Hearing Brief at 3.

⁴⁷ Ex. UNSE-34 (Grant Direct) at 3-7; Ex. UNSE-35 (Grant Rebuttal) at 6, 23.

1 evidence concerning the circumstances facing the Company.

2 Although Staff points to Exhibit S-51 as evidence supporting its proposed ROE, that
3 exhibit merely shows trends in authorized returns on equity without examining any other
4 particulars of individual utilities. This case is not simply about trends, as Staff would like the
5 Commission to assume.⁴⁸ In fact, many of the distribution companies were awarded ROEs in
6 recent years either equal to or above what Staff and RUCO recommend here, despite UNS
7 Electric's higher risk:

- 8 • Potomac Energy Power Company ("Pepco") – 10.50 percent ROE without a bill
9 stabilization adjustment in 2007.⁴⁹
- 10 • South Carolina Electric and Gas Company ("SCE&G") – 12.25 percent ROE before
11 a flotation adjustment of positive 20 basis points in 2003.⁵⁰
- 12 • Nevada Power Company ("NPC") – 10.70 percent ROE in 2007.⁵¹
- 13 • Puget Sound Energy, Inc. ("Puget") – 10.40 percent ROE in 2007.⁵² Puget serves
14 more than 1 million energy customers and with diversified generation holdings,
15 including company-controlled coal and hydroelectric resources.
- 16 • Arizona Public Service Company ("APS") – 10.75 percent ROE in 2007.⁵³

17 The Commission must look to the facts and evidence presented in this case, including
18 considering the risks of the utility when determining an appropriate return. *Pennsylvania Power &*
19 *Light Co. v. Public Service Comm'n*, 193 A. 427, 435 (Pa.Super. 1937). Simply relying on trends
20 ignores hard evidence of the Company's particular circumstances.

21 Even so, Exhibit S-51 indicates that the average ROE awarded in 2006 is 36 basis points
22 above what Staff recommends and 106 basis points above what RUCO recommends. And
23 ironically, Exhibit S-51 includes companies like Appalachian Power Company, Puget and NPC,

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25 ⁴⁸ See Staff's Post-Hearing Brief at 3.

26 ⁴⁹ 2007 WL 2159658 (Md.P.S.C.) at 40-41.

27 ⁵⁰ 2003 WL 1818431 (S.C.P.S.C.) at 35, 55.

⁵¹ 2007 WL 2171450 (Nev.P.U.C.) at ¶ 120.

⁵² 2007 WL 2184670 (Wash.U.T.C.) at 1.

⁵³ Decision No. 69663 at 49.

1 who have CWIP included in their respective rate bases.⁵⁴ In effect, Exhibit S-51 reveals the
2 unreasonableness of Staff's recommended ROE.

3 Staff has also mischaracterized the evidence when discussing return on equity. First,
4 UniSource Energy Corporation ("UniSource Energy") does not guarantee debt for UNS Electric.
5 UNS Electric has to assure lenders when it issues debt; and prospective lenders will look directly
6 to the financials of UNS Electric, as Mr. Parcell admitted during the hearing.⁵⁵ UNS Electric's
7 size will be a key factor to those lenders, as will its non-investment grade status. Further, equity
8 investors will look to UNS Electric's financials to the extent it affects UniSource Energy.⁵⁶ Also,
9 contrary to Staff's assertion, at page 21 of its Post-Hearing Brief, Mr. Grant did not make a 60-
10 basis-point adjustment simply due to UNS Electric's size or its non-investment grade status. UNS
11 Electric also does not pay a common dividend.⁵⁷ Given the recent turmoil in the capital markets,
12 these factors would support an even higher risk premium. UNS Electric's proposed ROE should
13 be adopted because it reasonably reflects the true risk faced by the Company.

14 **2. The Commission should adopt the Company's proposed capital**
15 **structure and cost of debt.**

16 Staff acknowledges, at page 17 of its Post-Hearing Brief, that the Company's capital
17 structure contains 48.85 percent equity as of June 30, 2007. The Company proposes a capital
18 structure with 48.85 percent equity that reflects the actual capital structure going-forward. There is
19 no argument that cost of capital is inherently forward-looking. There is no reason not to use the
20 Company's actual capital structure – including 48.85 percent equity, 47.18 percent long-term debt,
21 and 3.97 percent short-term debt.

22 The Company's proposed cost of long-term debt, 8.22 percent, also incorporates an
23 amendment to UNS Electric's credit agreement in 2006.⁵⁸ It is undisputed that this is the
24

25 ⁵⁴ Compare Ex. S-51 at 4 to 2007 WL 1616129 (Va.S.C.C.) at 4, 2007 WL 184670 (Wash.U.T.C.) at 39,
26 2007 WL 2171450 (Nev.P.C.) at ¶ 303.

⁵⁵ Tr. (Parcell) at 1137.

⁵⁶ Tr. (Parcell) at 1131-32, 1135.

⁵⁷ Ex. UNSE-35 (Grant Rebuttal) at 6.

⁵⁸ Ex. UNSE-35 (Grant Rebuttal) at 20.

1 Company's *actual* cost of long-term debt going forward. That rate should therefore be approved in
2 this case.

3 **D. Fair Value.**

4 **1. Staff's suggestion that RCND is not a good measure of fair value is**
5 **meritless.**

6 Even though Staff averages OCRB with RCND to determine its FVRB, Staff now
7 suggests, at page 23 of its Post-Hearing Brief, that RCND may not be a good measure of
8 determining fair value. However, Staff's position ignores the law and the evidence. Mr. Smith
9 insinuated that using RCND to establish UNS Electric's FVRB could result in a substantial
10 overstatement of FVRB.⁵⁹ But Mr. Smith does not provide any analysis as to the particular
11 circumstances that lead Citizens to sell those assets at that purchase price and what lead to the sale
12 at that price. Further, the negative acquisition adjustments resulting for the amount UniSource
13 Energy paid for the assets *are already incorporated into the rate base* for both the gas and electric
14 assets. Ratepayers will continue to benefit from these negative acquisition adjustments. Further
15 the Arizona Supreme Court indicated that a purchase price itself is not the relevant factor and
16 could be the product of circumstances bearing no impact on fair value:

17 [The] Commission must consider all available evidence related to the fair value,
18 and an inquiry into a recent purchase transaction might be of assistance, in the
19 discretion of the Commission. But the reasons for that purchase price and not the
20 amount itself would be of first importance in shedding light on the fair value of
21 the property. Certain facts concerning the physical condition of the properties or
22 what is actually used and useful, or the practical effects of particular business
practices might thus be revealed more clearly. A purchase price which was the
product of many considerations not relevant to fair value is, as a dollar figure,
obviously not in itself indicative of the fair value of the properties sold.

23 *Ariz. Corp. Comm'n v. Ariz. Water Company*, 85 Ariz. 198, 203-04, 335 P.2d 412, 415 (1959).

24 Therefore, the Commission should approve its traditional method averaging OCRB and RCND to
25 determine FVRB, as the Parties all did in this docket.

26
27

59 Ex. S-56 at 9.

1 **2. Staff's zero-investor-supplied capital theory ignores fair value and**
2 **cannot be approved.**

3 Although Staff argues, at page 23 of its Post-Hearing Brief, that the Company's position on
4 fair value rate of return is meritless, basic arithmetic confirms that Staff's new "investor supplied
5 capital theory" is equal to its old traditional methodology rejected by the Court of Appeals in
6 *Chaparral City Water Company v. Arizona Corp. Comm'n*. In the remanded proceedings, Staff
7 now abandons its traditional methodology for the new theory.⁶⁰ But even Staff witness Mr. Parcell
8 admits the new theory is equivalent to simply multiplying OCRB by COC.⁶¹ Thus, the "investor
9 supplied capital" theory from Mr. Parcell and Mr. Smith ignores fair value, is unlawful, and cannot
10 be approved by the Commission.

11 By way of further illustration, Staff's OCRB as stated in its final schedules equals
12 \$130,740,050.⁶² Multiplying that figure multiplied by Staff's 8.99 percent COC yields
13 \$11,753,531, although Staff's figure is \$11,749,701. Using Staff's actual rate of return on FVRB
14 produces a required operating income of \$11,762,085.⁶³ Thus, the difference between the two
15 operating income calculations is approximately \$8,554 to \$12,384, or about a 0.0727252 to
16 0.1052875 percent difference, confirming Mr. Parcell's admission that the two formulae are
17 mathematically the same – except perhaps for some nominal rounding difference. As a result,
18 Staff's new theory still effectively ignores fair value and is prohibited under Arizona law.

19 **II. UNS ELECTRIC'S PROPOSED RATE DESIGN IS REASONABLE.**

20 UNS Electric continues to support its progressive rate design proposals to support and
21 encourage conservation, including mandatory time-of-use ("TOU") rates and the inclining block
22

23 ⁶⁰ See Ralph C. Smith and David C. Parcell Direct Testimonies in Docket No. W-02113A-04-0616 (August
24 30, 2007).

25 ⁶¹ Tr. (Parcell) at 1187-88.

26 ⁶² See Staff's Notice of Filing Final Schedules (October 16, 2007) at Schedule A.

27 ⁶³ Staff's Notice of Filing Final Schedules at Schedule A. RUCO proposes a required operating income
using its method to determine ROR on FVRB that is exactly equal to taking its OCRB and multiplying
that figure by its COC – \$11,171,471. See RUCO's Notice of Filing Final Schedules (October 17, 2007)
at Schedule FINAL RLM-1. RUCO's method also ignores fair value and is unlawful. RUCO does not
address this issue in its Closing Brief, except to recommend an 8.67 ROR on its FVRB determination.

1 rate structure. The Company's rate design proposals are in the best interests of the Company's
2 customers because the proposals support (1) conservation efforts, and (2) cost savings attributable
3 to load shifting and capacity deferral. UNS Electric addresses the arguments raised by intervening
4 parties regarding the issues on which there remains disagreement, without waiving any of its
5 previous positions.

6 **A. Mandatory TOU Rates are for the Long-Term Benefit of Both the Company**
7 **and its Customers and are in the Public Interest.**

8 Only Staff does not support mandatory TOU rates in this case. Staff witness Mr. Frank
9 Radigan argues against the implementation of mandatory TOU rates based only upon the cost
10 differential between TOU and non-TOU meters. But Staff's position ignores the *long-term*
11 *benefits* of shifting load from peak times.⁶⁴ Further, Mr. D. Bentley Erdwurm testified that UNS
12 Electric is already moving toward smart metering, with TOU capabilities. As the Company
13 implements its plan to install TOU-capable, communication-capable meters, the cost differential to
14 which Mr. Radigan refers will disappear.⁶⁵ In addition, the Company's proposal takes into account
15 that putting *all* customers on mandatory TOU is costly over the short-term – due to the meters
16 needed.⁶⁶ UNS Electric's proposal is a gradual yet significant step towards moving all customers
17 to TOU rates. This is through mandating TOU for all new and moving residential customers,
18 small general service customers, large general service customers with maximum demand less than
19 1,000 kW, as well as for all large general service customers with maximum demand equal to or
20 greater than 1,000 kW and all Large Light and Power customers.

21 Further, for TOU rates to be truly effective in shaving peak load, all customers must be
22 asked to bear their fair share of responsibility and pay the actual costs of power they use.⁶⁷
23 Customers must notice the impact of using power at peak times and act accordingly to lower their
24 bills.⁶⁸ Mandatory participation is needed to truly advance conservation goals. The Company

25 ⁶⁴ Ex. UNSE-18 (Erdwurm Rebuttal) at 12-13; Tr. (Erdwurm) at 472-74.

26 ⁶⁵ Ex UNSE-18 (Erdwurm Rebuttal) at 12-13.

27 ⁶⁶ Ex. UNSE-17 (Erdwurm Direct) at 18.

⁶⁷ Tr. (Erdwurm) at 472-74.

⁶⁸ Tr. (Erdwurm) at 475.

1 already has a TOU education program to encourage customers to shift use.⁶⁹ RUCO understands
2 that mandatory TOU will allow the Company to “further shave peak load, while at the same time
3 [provide] an incentive for customers to shift load and save money.”⁷⁰

4 Finally, support of mandatory TOU rates would be consistent with an approach of
5 developing conservation, demand-side management and renewables issues over a longer time
6 period. Mr. Erdwurm cites the Commission’s new Renewable Energy Standard (“RES”) Rules in
7 Decision No. 69127 (November 14, 2006) as “a classic example” of it supporting an
8 environmentally friendly program with a long-term outlook.⁷¹ In both cases, programs that may
9 not be economically viable given today's cost structure are encouraged in anticipation of future
10 efficiency and technology improvements, as well as net cost reductions that will come with
11 increased use.

12 The evidence - and good public policy - support mandatory TOU rates in this case.
13 Therefore, they should be implemented as a key means to support conservation, lower average
14 energy costs through shaving from peak load, and being in the public interest.

15 **B. This is the Appropriate Time to Implement Inclining/Inverted Block Rate**
16 **Structure in this Rate Case.**

17 While Staff supports the concept of the inclining block rate structure, Mr. Radigan is
18 concerned that the requested rate increase is too small to implement such a change now, and that
19 the new rate design will be confusing for customers. However, Staff has supported inverted block
20 rate designs in a number of cases because it believed it advanced the goal of supporting
21 conservation.⁷² Now, Staff through Mr. Radigan recommends that the inverted block rate design
22 not be implemented in this case.

24 ⁶⁹ Tr. (D. Smith) at 626-27.

25 ⁷⁰ Ex. RUCO-9 (Díaz Cortez Direct) at 4.

26 ⁷¹ Ex. UNSE-18 (Erdwurm Rebuttal) at 13-14.

27 ⁷² See Decision Nos. 67093 (June 30, 2004 – Arizona American Water Company), 68858 (July 28, 2006 – Arizona American Water Company Paradise Valley Water District), 68302 (November 14, 2005 – Arizona Water Company’s Western Group).

1 UNS Electric continues to support the immediate implementation of its proposed inclining
2 block rate structure. This is precisely the time to implement such a rate design change, when the
3 requested rate increase is relatively small. Further, Mr. Radigan acknowledged at the rate case
4 hearing that the customer confusion about which he is concerned may be alleviated through the
5 Company's customer education efforts.⁷³ The bottom line is that tiered inverted block rates send a
6 strong price signal to conserve because of the higher rate per kWh beyond each breakover point.⁷⁴
7 Simply put, there is no good reason to delay approval of an inverted block rate design in this
8 proceeding as the Company proposes.

9 **C. The Rates for Mohave and Santa Cruz Counties should be Consolidated in**
10 **this Proceeding.**

11 Staff's argument that the rate increase is too small to justify consolidation is unwarranted.
12 The evidence is undisputed that UNS Electric is running its Mohave County and its Santa Cruz
13 County operations as one system.⁷⁵ Because its operations are combined, having higher rates for
14 Santa Cruz County customers than for Mohave County customers is inequitable.⁷⁶ The inequity
15 can and should be addressed here, particularly given the relatively small overall base rate increase
16 UNS Electric is seeking.⁷⁷

17 **D. UNS Electric's Demand Charge Proposal for Large Service Customers is**
18 **Reasonable.**

19 UNS Electric understands Staff's concerns with reducing the demand charge differential
20 for Large Service Customers (those customers taking power at 69 kV and above) and those for
21 whom power has been stepped down. As Mr. Erdwurm indicated during the hearing, it will be
22 beneficial to perform a study for the next general rate case, such that a true cost-based differential
23 may be determined.⁷⁸ However, the Company's approach is one of common sense. Specifically,
24

25 ⁷³ Tr. (Radigan) at 1267.

26 ⁷⁴ Ex. UNSE-18 (Erdwurm Rebuttal) at 9-10.

27 ⁷⁵ Tr. (Erdwurm) at 460; Tr. (Ferry) at 485.

⁷⁶ Ex. UNSE-18 (Erdwurm) at 15; Tr. (Erdwurm) at 460.

⁷⁷ Tr. (Erdwurm) at 460-63.

⁷⁸ Tr. (Erdwurm) at 469.

1 when a demand charge differential greatly exceeds the bounds of what typically occurs - and this
2 may be determined without conducting a study - then any immediate reduction in the demand
3 charge differential helps ensure that lower load factor customers do not overpay for energy. This
4 has economic development implications; hence some reduction in the demand charge differential
5 is in the public interest.

6 **E. The Purchased Power Allocation should be based in Part Upon Average and**
7 **Peaks, and in Part Upon Energy.**

8 In its Post-Hearing Brief, Staff misstates the Company's position on the purchased power
9 allocation. While Mr. Erdwurm did originally propose allocating all purchased power using the
10 Average and Peaks Method, he then proposed a purchased power allocation of 50 percent each for
11 capacity and energy - using the average and peaks method for the capacity portion.⁷⁹ But given
12 that UNS Electric likely has a lower system load factor than TEP - and TEP uses a purchased
13 power allocation with a 50/50 split between capacity and energy - a lower capacity allocation of
14 40 percent versus a 60 percent energy allocation makes sense for UNS Electric.⁸⁰ The Company,
15 therefore, proposes using a purchased power allocation of 40 percent capacity and 60 percent
16 energy for the next rate case.

17 Further, Mr. Erdwurm explained why Mr. Radigan's 100-percent energy allocation is
18 flawed. The 100-percent energy allocation does not recognize that wholesale energy purchase
19 prices are affected by both the level of the energy sale and the load factor.⁸¹ Based upon the
20 economic concept that fixed costs per unit decline as volume increases, low load factor customers
21 are more costly to serve, other things being constant. The fact that the current contract with
22 Pinnacle West, for simplicity, used a volumetric pricing structure implies nothing to contradict Mr.
23 Erdwurm's position. In fact, the average price of purchased power for UNS Electric was
24 influenced by load factor and Pinnacle West took into account the load characteristics when the
25

26 _____
27 ⁷⁹ Ex. UNSE-18 (Erdwurm Rebuttal) at 6-7.

⁸⁰ Ex. UNSE-18 (Erdwurm Rebuttal) at 7.

⁸¹ Ex. UNSE-18 (Erdwurm Rebuttal) at 6-7.

1 contract was entered with then-Citizen's Arizona Electric Division.⁸² The influence of load factor
2 will become more pronounced once the Pinnacle West contract expires.⁸³ Using a purchased
3 power allocation of 100-percent energy ignores the realities of the marketplace.

4 **III. UNS ELECTRIC'S CARES DISCOUNT BENEFITS LOW-INCOME CUSTOMERS**
5 **WHILE PROMOTING CONSERVATION.**

6 While RUCO supports the Company's CARES and CARES-Medical discount proposals,
7 Staff does not. Staff advocates for the retention of the current CARES and CARES-Medical
8 discounts, which provide declining percentage discounts for participating customers, with a flat
9 \$8.00 discount for usage over a 1,000 kWh threshold for CARES customers, and a 2,000 kWh
10 threshold for CARES-Medical customers.

11 Because the other parties did not speak to low-income issues in their initial briefs, the
12 Company simply reiterates its belief that its proposed CARES discount, and its requests related to
13 other low-income customer issues, are all supported in the record in this case, as set forth in its
14 Initial Post-Hearing Brief.

15 **IV. DEMAND-SIDE MANAGEMENT ("DSM") COST RECOVERY.**

16 The Company agrees to establish a DSM adjustor mechanism, and to set the initial rate at
17 \$0.000583 per kWh. This represents funding 100 percent of the expanded low-income
18 weatherization ("LIW") program costs and 25 percent of all other proposed DSM program costs
19 through the DSM adjustor mechanism.⁸⁴ The Company, Staff and RUCO appear to agree on this
20 point.

21 Mr. Magruder proposes that one date be used for the annual adjustments of the DSM, RES
22 and PPFAC rate adjustors. Currently, the DSM adjustor is scheduled for implementation on June
23 1st of each year, although Mr. Magruder mistakenly references a January implementation date. As
24 Staff witness Mr. Jerry Anderson stated in his Direct Testimony, "Staff recommends that UNS
25 Electric's DSM adjustor rate be reset annually on June 1 of each year beginning June 1, 2009; and

26 _____
27 ⁸² Ex. UNSE-18 (Erdworm Rebuttal) at 8.

⁸³ Ex. UNSE-19 (Erdworm Rejoinder) at 3-4.

⁸⁴ Ex. UNSE-6 (Pignatelli Rebuttal) at 15; Ex. S-63 (Anderson Direct) at 15-16.

1 that the per kWh rate be based upon currently projected DSM costs for that year, adjusted by the
2 previous year's over- or under- collection, divided by projected retail sales (kWh) for that same
3 year."⁸⁵ The Company agrees with Staff's comments and recommendations.⁸⁶ Annual
4 adjustments for charges related to the RES depend on approval of the Company's RES Tariff and
5 Implementation Plan, described below.

6 Mr. Magruder makes an abundance of recommendations concerning DSM – most of which
7 the Company opposes. Even so, the Company understands that Staff continues to evaluate the
8 Company's comprehensive DSM Program Portfolio Plan in Docket No. E-04204-07-0365. That
9 filing is incorporated by reference in this case as the Company's DSM proposal. UNS Electric
10 recommends implementation of the DSM Program Portfolio Plan it filed in Docket No. E-
11 04204A-06-0365 on June 13, 2007 (the "DSM Docket").

12 **V. UNS ELECTRIC'S PROPOSED CHANGES TO ITS RULES AND REGULATIONS**
13 **ARE REASONABLE.**

14 **A. The Company's Proposed Billing Terms are More Lenient than Commission**
15 **Rules Allow.**

16 The Company understands that the Commission's rules differ between gas utilities and
17 electric utilities. The fact remains that – to match UNS Electric billing terms to UNS Gas billing
18 terms – UNS Electric proposes billing terms that allow for 25 total days before a bill becomes
19 delinquent.⁸⁷ That is *more* lenient than A.A.C. R14-2-210.C. The Company's proposal regarding
20 billing terms is fair and equitable to customers and unifies billing terms for customers served by
21 both UNS Gas and UNS Electric.

22 **B. Staff Misconstrues the Company's Proposal Regarding Line Extensions and**
23 **Free Footage.**

24 Exhibits UNSE-54, UNSE-55 and UNSE-56 make it clear that the Company's proposal is
25 to *eliminate* 50 feet and one carryover pole from its overhead service line connection.⁸⁸ Further,

26 ⁸⁵ Ex. S-63 (Anderson Direct) at 14.

27 ⁸⁶ Ex. UNSE-28 (D. Smith Rebuttal) at 21.

⁸⁷ Ex. UNSE-21 (Ferry Rebuttal) at 2.

⁸⁸ See Ex. UNSE-21 (Ferry Rebuttal) at 9.

1 the Company does not contend that A.A.C. R14-2-207 requires a free footage allowance; rather,
2 the Company is concerned that Staff's proposal proposes a major shift in policy that will likely
3 have adverse impacts on economic development efforts in places like Kingman, Lake Havasu City
4 and Nogales.⁸⁹ It is also important to note that the Company did propose a Service Connection
5 Fee of \$250 for each new electric service connection.⁹⁰ The Company believes that its two
6 proposals represent a better balancing of all interests than simply eliminating free footage as urged
7 by Staff.

8 **C. Mr. Magruder's Recommendations.**

9 Mr. Magruder makes several recommendations regarding UNS Electric's Rules. These
10 recommendations include that the Rules be: (1) rewritten in "plain" language; (2) provided to each
11 customer; (3) translated into Spanish; and (4) reformatted. UNS Electric's proposed Rules are in
12 compliance with the A.A.C. and UNS Electric recommends implementation of the proposed Rules
13 as soon as possible. In fact, much of the language in the Company's Rules comes directly from the
14 Commission's Rules and is organized very similarly to the Commission's Rules. The Company
15 already provides copies of applicable rules for new customers requiring line extensions. Providing
16 a copy of the rules to all customers – especially when they are available online – is extremely
17 costly to the ratepayer. Finally, UNS Electric has no objection to translating the rules and
18 regulations into Spanish and making that version available online.

19 **VI. PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE ("PPFAC").**

20 The Company and Staff largely agree on the general structure to the PPFAC and the
21 Company will not repeat those details here.⁹¹ Two areas of disagreement clearly remain: (1)
22 permitting other allowable costs through the PPFAC; and (2) Staff's last-minute proposal for a cap
23 on the PPFAC.

24
25
26 ⁸⁹ Ex. UNSE-21 (Ferry Rebuttal) at 9-10. Based on the language of A.A.C. R14-2-207.C., it does not
appear that a free footage allowance is required per se. Still allowing a set amount of free footage had
been widely practiced amongst electric utilities in Arizona.

27 ⁹⁰ Ex. UNSE-46.

⁹¹ See UNS Electric's Initial Post-Hearing Brief at 66-68 for discussion on the PPFAC.

1 First, Staff does not refute that UNS Electric does not have procurement, scheduling and
2 management costs in base rates because of the full requirements purchased power contract with
3 Pinnacle West Capital Corporation ("Pinnacle West").⁹² RUCO admits these costs are not
4 reflected in test-year expenses, but the Company will incur these costs as it replaces the Pinnacle
5 West contract.⁹³ Further, because the costs are likely to vary year-to-year and are an inevitable
6 part of procuring fuel and purchased power, it makes more senses to recover those costs through
7 the PPFAC.⁹⁴ In the alternative, the Company requests the Commission approve forecasted
8 procurement, scheduling and management fees set forth in Exhibit MJD-6 to Mr. DeConcini's
9 Rejoinder Testimony.⁹⁵

10 Second, regarding a cap on the PPFAC, Staff states only, at page 41 of its Post-Hearing
11 Brief, that "due to late-filed information by the Company regarding prospective gas prices, Staff is
12 also recommending a cap on the PPFAC in order to prevent rate shock." Although Staff provides
13 absolutely no further analysis of the rate cap, Staff witness Mr. Smith has acknowledged that caps
14 can lead to large deferrals that can negatively impact the Company, by making it a riskier
15 investment.⁹⁶ UNS Electric's customers will have to pay for those cost deferrals eventually.⁹⁷
16 Mr. Smith also admits that it would not be appropriate to force a cap on the PPFAC in this period
17 of flux for UNS Electric and that a cap could improperly encourage short-term rate stability at the
18 expense of serving the long-term interests of customers.⁹⁸ The Company would have to finance
19 any deferral. If the deferrals become large, it is unclear whether Company's revolving credit
20 facility can cover those costs being deferred; this leads to further uncertainty over financing and
21 the costs of financing.⁹⁹

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24 ⁹² Ex. UNSE-15 (DeConcini Rebuttal) at 15; Ex. UNSE-16 (DeConcini Rejoinder) at 3; Tr. (DeConcini) at 339-40, 341-42.

25 ⁹³ Tr. (Diaz Cortez) at 1275, 1281-83.

26 ⁹⁴ Tr. (R. Smith) at 1226.

27 ⁹⁵ Ex. UNSE-16 (DeConcini Rejoinder) at 3-4, Ex. MJD-6; Tr. (DeConcini) at 337-38, 345.

⁹⁶ Ex. S-58 (Smith Surrebuttal) at 54.

⁹⁷ Ex. S-58 (Smith Surrebuttal) at 54.

⁹⁸ Ex. S-58 (Smith Surrebuttal) at 54.

⁹⁹ Tr. (Grant) at 1411-12.

1 Staff confusingly suggests (or may suggest) at pages 40-41 of its Post-Hearing Brief, that
2 capacity costs should be covered through base rates, not through the PPFAC, citing the Direct
3 Testimony of Staff witness Ralph Smith. However, that testimony was a general discussion of
4 PPFACs and is inconsistent with both Mr. Smith's Surrebuttal Testimony as well as the PPFAC
5 and Plan of Administration ("POA") actually proposed by Mr. Smith.¹⁰⁰ To begin with, the
6 PPFAC adopted by the Commission for APS (the "Power Supply Adjustor") - and proposed by
7 Staff in this docket - does include recovery of capacity cost.¹⁰¹ Moreover, the redlined POA in
8 Mr. Smith's Surrebuttal Testimony provides for recovery for costs in FERC Account Nos. 555
9 (Purchased Power) and 565 (Wheeling (Transmission of Electricity by Others)).¹⁰² Those FERC
10 accounts expressly include capacity costs. Nowhere in Mr. Smith's Surrebuttal, nor in the POA,
11 are capacity costs excluded from recovery through the PPFAC.

12 Mr. Smith's Surrebuttal Testimony provides ample reason why capacity costs should be
13 recovered through UNS Electric's PPFAC. First, when the Pinnacle West contract expires, the
14 Company's fuel and purchased power costs may be significantly different than they have been
15 while the Pinnacle West contract was in effect.¹⁰³ UNS Electric will not have the same degree of
16 control over its fuel and purchased power costs upon expiration of the Pinnacle West contract and
17 it would be unrealistic to expect that UNS Electric would be able to keep its costs close to those
18 under the Pinnacle West contract.¹⁰⁴ Second, Mr. Smith states that UNS Electric will not receive
19 any return on its prudently incurred fuel and purchased power costs and that he believes the
20 Company should be allowed to recover through the PPFAC the costs included in FERC accounts
21 501, 547, 555 and 565 as well as the prudent direct cost of contracts used for hedging system fuel
22 and purchased power costs.¹⁰⁵ In defining the parameters of costs to be recovered under the
23 PPFAC, Mr. Smith only took exception to the category of "other includible costs" and certainly

24 ¹⁰⁰ Compare Staff's Post-Hearing Brief at 40-41 to Ex. S-58 (R. Smith Surrebuttal) at Ex. RCS-7 at 12.

25 ¹⁰¹ See Staff's Notice of Filing: Revised Plan of Administration in Docket No. E-01345A-05-0816 (July
26 30, 2007) at Page 11.

26 ¹⁰² Ex. S-58 (R. Smith Surrebuttal) at Ex. RCS-7 at 12.

27 ¹⁰³ Ex. S-58 (R. Smith Surrebuttal) at 49.

¹⁰⁴ Ex. S-58 (R. Smith Surrebuttal) at 49-50.

¹⁰⁵ Ex. S-58 (R. Smith Surrebuttal) at 55-57, 63.

1 not capacity costs under the specified FERC accounts.¹⁰⁶ Indeed, Mr. Smith expressly notes that a
2 well-designed PPFAC would avoid situations where delayed recovery of prudent and reasonable
3 fuel and energy costs would have material financial consequences on a company; thus, allowing
4 reasonably prompt recovery of prudent fuel and energy costs.¹⁰⁷ Yet, now Staff may be suggesting
5 that UNS Electric be prevented from recovering the prudent capacity costs of its new power supply
6 through the PPFAC. That new position should be rejected.

7 In fact, allowing recovery of capacity costs through the PPFAC makes particularly good
8 sense here. UNS Electric has no historic level of purchased capacity costs that could be included
9 in base rates because of the Pinnacle West contract and as Staff has acknowledged, the Company's
10 power supply portfolio will be completely different as of June 1, 2008. If capacity costs are not
11 allowed to be recovered through the PPFAC, it would simply preclude UNS Electric from any
12 recovery of those costs because the base rates do not reflect capacity costs related to the new
13 power supply portfolio. That circumstance would create an incentive to have capacity costs
14 included in energy costs (which may result in increased costs). In sum, capacity costs are directly
15 related to purchased power and transmission, are included in FERC Account Nos. 555 and 565,
16 and should be recovered.

17 Finally, RUCO continues to press, at pages 3-4 of its Closing Brief, for its PPFAC
18 involving a historical twelve-month rolling average mechanism as its proposal. Both Staff and the
19 Company believe RUCO's proposal should be rejected and the Company stands by its Initial Brief
20 regarding RUCO's proposal.

21 The Company believes the PPFAC as put forth in its Rebuttal Testimony and detail in its
22 POA is the best means to promptly recover fuel and purchased power. The Company further
23 agrees with Staff's proposed changes – as provided in Staff's redlined POA in its Surrebuttal
24 Testimony – with the exception of its position on other allowable costs and a cap.

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27 ¹⁰⁶ Ex. S-58 (R. Smith Surrebuttal) at 63 and Ex. RCS-7 thereto at 12

¹⁰⁷ Ex. S-58 (R. Smith Surrebuttal) at 60-61.

1 **VII. BLACK MOUNTAIN GENERATION STATION (“BMGS”).**

2 UNS Electric understands that it is requesting unusual rate base treatment for BMGS.
3 However, the unique facts and circumstances, as well as the benefits of BMGS to both the
4 Company and its customers, justify the rate base and rate reclassification treatment sought by UNS
5 Electric. To be clear, the requested treatment of BMGS is conditioned upon UNS Electric
6 acquiring BMGS. Although UNS Electric does not own BMGS now, if the Commission approves
7 the Company’s request, then the Company *will* acquire BMGS at cost. The rate base adjustment
8 will be a fixed, known and measurable amount of \$60 million and the adjustment will take place
9 on June 1, 2008 or the date on which BMGS is operational, whichever is later. At the date BMGS
10 is put into rate base, the Company will institute a revenue-neutral rate reclassification – increasing
11 the base delivery charge by 0.6 cents per kWh while simultaneously decreasing the base power
12 supply charge by 0.6 cents per kWh. UNS Electric is not requesting that the prudence of the
13 construction cost of BMGS be decided in this docket. That will take place in the next rate case.
14 UNS Electric also will not seek to recover any BMGS costs in excess of \$60 million until the next
15 rate case.

16 The Company will be unable to acquire BMGS if the Commission does not grant the
17 Company’s proposed treatment of BMGS. Without that approval, the Company cannot finance the
18 acquisition of BMGS.¹⁰⁸ The cost of BMGS, which is \$60 to \$65 million, represents no less than
19 42.5 percent of the Company’s OCRB figure – and a higher percentage per Staff’s OCRB figure.
20 The rate reclassification adds \$10 million in non-fuel revenue requirement – resulting in an
21 additional \$3 million in net income and \$6 million in operating cash flow needed to service the
22 additional capital raised.¹⁰⁹ An accounting order or other deferral will not add the cash flows
23 needed to finance the acquisition.¹¹⁰ And a purchased power contract between UniSource Energy
24 Development Company (“UEDC”) and UNS Electric will not provide long-term benefits to UNS
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27 ¹⁰⁸ Ex. UNSE-8 (Larson Direct) at 6-8.

¹⁰⁹ Ex. UNSE-8 (Larson Direct) at 10, Ex. KPL-2; Ex. UNSE-9 (Larson Rebuttal) at 8, 11.

¹¹⁰ Ex. UNSE-9 (Larson Rebuttal) at 6.

1 Electric and its customers.¹¹¹

2 Ironically, Staff appears to agree that acquisition of BMGS is beneficial to the Company
3 and its customers. It also has recommended approval of financing of up to \$40 million in new
4 debt and \$40 in additional equity infusion to allow the acquisition. However, Staff has balked at
5 taking the final step necessary to allow UNS Electric to acquire BMGS in a cost effective manner
6 that is in the public interest.

7 **A. The Evidence is Undisputed that UNS Electric Acquiring BMGS Provides**
8 **Numerous and Substantial Benefits to the Company and its Customers.**

9 The operational and financial benefits of BMGS remain unrefuted. UNS Electric
10 ownership will save ratepayers millions over the 30-to-40-year life of the asset versus purchased
11 power.¹¹² And, if the purchased power demand charge were to be higher than \$7 per month per
12 kW, then the savings would be more pronounced due to the cumulative impacts of ADIT and
13 depreciation expense that reduce the Company's revenue requirement for owned generating
14 capacity.¹¹³ Moreover, the Company avoids having to pay escalators commonly-associated with
15 PPAs that often increase over time.¹¹⁴ Further, improved cash flow from BMGS provides
16 additional funding for UNS Electric's ongoing construction program, improves its credit profile,
17 and allows the Company to attract financing on more reasonable terms.¹¹⁵

18 The operational benefits – including full operational flexibility, full control over
19 maintenance and operation, having in-house generation to exactly meet peak capacity and reserve
20 needs, and having generation at a location that minimizes transmission costs – are all undisputed.
21 In fact, Staff's engineering personnel involved in this case recognized the substantial benefits
22 BMGS would provide.¹¹⁶ The 90 MW facility would significantly improve and diversify UNS
23 Electric's power portfolio, especially given the need to procure 450 MW of generating capacity
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25 ¹¹¹ Ex. UNSE-9 (Larson Rebuttal) at 13.

26 ¹¹² Ex. UNSE-8 (Larson Direct) at 14, Ex. KPL-3.

27 ¹¹³ Ex. UNSE-8 (Larson Direct) at 13.

¹¹⁴ Ex. UNSE-14 (DeConcini Rebuttal) at 4.

¹¹⁵ Ex. UNSE-9 (Larson Rebuttal) at 4.

¹¹⁶ Ex. UNSE-52

1 due to the Pinnacle West contract expiring on May 31, 2008.¹¹⁷

2 **B. Staff and RUCO's Arguments against Rate-Basing BMGS are Unfounded.**

3 Rather than challenge the financial and operational benefits of BMGS and the unique
4 circumstances facing UNS Electric, Staff and RUCO assert general ratemaking principles as
5 somehow justifying their arguments against the Company's proposal.

6 First, Staff's concern that UNS Electric does not own BMGS is perplexing. The purpose
7 of the proposed rate base treatment is to allow the Company to acquire BMGS and rate base the
8 asset close to the time the Pinnacle West contract expires. UNS Electric *will* own BMGS if the
9 Commission approves its request. The Company's witnesses have testified numerous times that
10 UEDC *will* sell BMGS *at cost* to UNS Electric.¹¹⁸ Only if the Commission rejects UNS Electric's
11 proposal will other opportunities be pursued.¹¹⁹

12 Second, contrary to Staff's belief, the BMGS proposal is not CWIP. Indeed, UNS Electric
13 has no CWIP or AFUDC related to BMGS because it is not building BMGS. BMGS will not enter
14 rate base until it is acquired by UNS Electric and is fully operational.

15 Third, UNS Electric does not dispute Staff's statement that BMGS was not used and useful
16 during the test year. But that is not the issue. BMGS is a generation asset that will partially
17 replace the Pinnacle West contract upon its expiration. The in-service date is projected to be May
18 1, 2008.¹²⁰ The rate reclassification will not occur until *after* BMGS is in commercial operation
19 or June 1, 2008 (the date the Pinnacle West contract expires), whichever is later. Even so, the
20 Company will file its completion report to confirm the plant is in service, used and useful and
21 serving existing customers.¹²¹ The plant will be used and useful and serving *existing* customers
22 when the post-test-year adjustment takes effect.

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25 ¹¹⁷ Ex. UNSE-15 (DeConcini Rebuttal) at 3.

26 ¹¹⁸ Ex. UNSE-9 (Larson Rebuttal) at 12; Ex. UNSE-15 (DeConcini Rebuttal) at 4; Tr. (Larson) at 193-94;
Tr. (DeConcini) at 309.

27 ¹¹⁹ Tr. (Larson) at 195; Tr. (DeConcini) at 305-07.

¹²⁰ Tr. (DeConcini) at 308-09.

¹²¹ Ex. UNSE-8 (Larson Direct) at 4; Ex. UNSE-9 (Larson Rebuttal) at 12.

1 Fourth, contrary to Staff's assertion, the rate base adjustment is known and measurable.
2 UNS Electric is requesting a set amount – \$60 million – to be added to rate base reflecting the
3 addition of BMGS. This is a known and measurable amount representing the \$46 million fixed-
4 price turnkey construction contract plus \$14 million in additional costs.¹²² If the additional costs
5 exceed \$14 million – and those costs could be between \$14 million and \$19 million – *any*
6 additional amount above \$60 million is not part of the Company's proposal in this proceeding.
7 Further, any so-called "cost overruns" will not be recovered until the next UNS Electric rate case
8 is adjudicated when parties will be allowed to fully examine the prudence of the BMGS
9 construction costs. Finally, the \$60 million reflects only the cost of the plant – \$60 million will be
10 added to rate base and a revenue neutral rate reclassification will occur.

11 Fifth, Staff's concern that UNS Electric is not building BMGS is neither probative nor
12 material to whether rate-basing BMGS is in the public interest. In fact, UNS Electric avoids the
13 risks associated with building BMGS; UEDC incurs that risk.¹²³ Further, Staff's assertion that
14 there is no construction taking place is false. Mr. Larson testified that construction is underway.¹²⁴
15 And regardless of the Commission's decision in this case, the BMGS construction will continue
16 and is scheduled to be completed May 1, 2008.¹²⁵ Because BMGS was intended to partially
17 replace the full requirements contract with Pinnacle West that expires on May 31, 2008, it made no
18 sense to plan construction to be completed before May 2008.

19 Finally, with respect to Staff's concerns over the ultimate prudence of acquiring BMGS,
20 the Company understands and accepts that the Commission reserves its right to determine the
21 prudence of BMGS construction costs in the next UNS Electric rate case.¹²⁶ The Commission
22 could disallow costs and order a refund and has reserved that right in reviewing fuel and purchased
23 power costs passed through adjustor mechanisms, for example. But it is the Company that bears
24 the risk. Further, even Staff witness Mr. Smith acknowledges that BMGS represents a good

25 ¹²² Ex. UNSE-8 (Larson Direct) at 4; Tr. (Larson) at 207; Tr. (DeConcini) at 309-10.

26 ¹²³ Tr. (Larson) at 214.

27 ¹²⁴ Tr. (Larson) at 220.

¹²⁵ Tr. (DeConcini) at 305, 308-09, 383.

¹²⁶ Ex. UNSE-9 (Larson Rebuttal) at 12; Tr. (Larson) at 167.

1 opportunity for UNS Electric.¹²⁷ Exhibit UNSE-43 shows that UNS Electric acquiring BMGS will
2 not harm customers compared to purchasing power in the short term; and may even save
3 customers from additional transmission costs and ancillary service costs.¹²⁸ Delay will only
4 increase the cost of acquiring BMGS – if the Company could even afford to do so in the future –
5 and will interfere with a golden opportunity to develop a diverse power supply portfolio at the time
6 the Pinnacle West contract expires.

7 RUCO opposes BMGS by setting forth a list of general regulatory principles that may be
8 contrary to the proposed treatment of BMGS. Although the treatment of BMGS is unusual, it is
9 not prohibited by law. Further, the Company's specific proposal and the benefits of BMGS either
10 refute or ameliorate RUCO's general regulatory concerns, as explained in detail in Mr. Larson's
11 Rebuttal Testimony:

12 **Known and measurable principal.**

13 The costs of BMGS will be known prior to the rate reclassification. As stated
14 above, the Company's proposed adjustment to rate base reflects the minimum cost
15 estimate of \$60 million; we are proposing a known and reasonably measurable –
16 and minimal – cost. As of June 30, 2007, approximately \$33 million had been
17 spent on BMGS. Even if actual project costs exceed this amount, UNS Electric is
18 not seeking rate base treatment for any additional amount in this case; it will wait
19 until the Company's next general rate case. Following the purchase of the project
20 by UNS Electric, and upon commercial operation of the facility, the Company will
21 provide the Commission with a project completion report detailing the cost of
22 completion and the results of pre-commercial testing. Thirty days after this report
23 has been filed, or on June 1, 2008 if the project is completed prior to May 1, 2008,
24 the Company would then implement the rate reclassification described above.
25 The Company is not proposing that the post-test-year adjustment of BMGS take
26 effect until after the facility is providing electricity to UNS Electric's customers
(i.e. used and useful.) Further, no one disputes that the plant is going to serve
existing customers as of June 1, 2008 because that is when the PWCC purchased
power contract expires. In addition, the Commission still has the authority to
review of construction costs to ensure they are prudent in the next rate case.

22 **Matching principal.**

23 The Company's rate reclassification proposal is designed to *exactly* match the
24 timing of rate recovery with purchased power cost avoidance. The effect of this
25 post-test-year adjustment is to add approximately \$10 million to the Company's
26 non-fuel revenue requirement, assuming a \$60 million project completion cost.
On the effective date of this adjustment, UNS Electric would increase the average
base delivery charge to customers by approximately 0.6 cents per kWh, *and* make
a corresponding decrease of 0.6 cents per kWh to the base power supply rate. If

27 ¹²⁷ Tr. (R. Smith) at 1237-38.

¹²⁸ Tr. (Grant) at 965.

1 UNS Electric acquires BMGS, it can reduce the base power supply rate because
2 the Company will (1) avoid buying up to 90 MW of wholesale market capacity;
3 (2) have a large portion of required ancillary services; and (3) have a significant
4 volume of wholesale transmission wheeling due to BMGS' location. Again, the
5 plant would serve existing customers, particularly given the expiration of the
6 PWCC contract at the end of May 2008; BMGS is not a "revenue enhancer" to
7 simply address future growth as RUCO seems to suggest without any support. So,
8 this is a case where abiding by RUCO's strict interpretation of the matching
9 principle would mean the Company and its customers would miss out on the
10 opportunity to obtain both financial and operational benefits from rate basing
11 BMGS.

12 **Historical test year principal.**

13 The PWCC contract, which currently supplies nearly all of UNS Electric's energy
14 requirements, did not expire during the test year. The PWCC contract expires on
15 May 31, 2008 and UNS Electric must begin procuring energy or generation now
16 to supply nearly all of its customers' energy demand beginning June 1, 2008.
17 UNS Electric does not have the luxury of waiting until 2010 for non-fuel cost
18 recovery for an asset that would increase the Company's test-year OCRB by 43%
19 and requires financing that would increase the Company's test year capitalization
20 by approximately 50%. The Commission's regulations allow for pro forma
21 adjustments when appropriate. The Company believes that such an adjustment is
22 appropriate in this situation.

23 **Used and useful principal.**

24 Upon receipt of the completion report of BMGS, the Commission will confirm
25 that the asset is used and useful. No one disputes that the plant will serve *existing*
26 customers once in commercial operation, starting June 1, 2008. The proposed rate
27 reclassification will not occur until the Commission reviews this report.

Related party transaction.

UNS Electric has committed to acquiring BMGS at *cost* from UEDC. UNS
Electric is open to a full a prudence review of those costs in the next rate case.

Pre-determination of prudence.

The only "pre-determination" being sought by UNS Electric is that the acquisition
of BMGS is in the public interest. The financial and operating benefits are
summarized in this testimony and are fully addressed in my Direct Testimony and
in Mr. DeConcini's Direct Testimony. The Commission maintains its authority to
review construction costs in its next rate case.¹²⁹

The bottom line is that UNS Electric will own BMGS if the Commission approves: (1) its
proposal to rate base BMGS at \$60 million; (2) its proposed rate reclassification that will add \$10
million to the non-fuel revenue requirement per year – moving 0.6 cents per kWh from the base
power supply charge to the base delivery charge; and (3) the requested financing authority for
BMGS. That ownership will provide numerous operational and financial benefits to UNS Electric
over the long-term as the uncontroverted evidence in the record shows.

¹²⁹ UNSE-9 (Larson Rebuttal) at 10-12.

1 **VIII. RENEWABLE ENERGY STANDARD/ENVIRONMENTAL PORTFOLIO**
2 **STANDARD ISSUES.**

3 The Company filed its Application for Approval of UNS Electric's RES Implementation
4 Plan and Associated Tariff on October 12, 2007. See Docket No. E-04204-07-0593. That
5 application requests clarification that – upon approval of its application – UNS Electric be released
6 from any and all obligations under A.A.C. R14-2-1618 that is the Environmental Portfolio
7 Standard ("EPS"). That application also sought clarification on how to use EPS funds and whether
8 those funds can be used toward RES program expenses. The Company maintains that issues
9 involving the EPS and REST, including its Environmentally Friendly Portfolio Surcharge
10 ("EFPS") are better addressed in UNS Electric's RES Tariff docket. Staff appears to agree.¹³⁰
11 Further, the Company will be required to file annual Compliance Reports (every April 1st) and
12 Implementation Plans (every July 1st). A.A.C. R14-2-1812 and -1813. It is expected that the
13 Company's RES Tariff Docket will also determine the effective date and reset date for the RES
14 adjustor charge.

15 **IX. OTHER ISSUES.**

16 **A. Life-Support Notification.**

17 Mr. Magruder has asserted that for customers who utilize life-support equipment in their
18 homes, the Company should be responsible for providing the names and addresses of those
19 customers to emergency response agencies. The Company is not in favor of sharing customer-
20 specific information with third parties. Even if the Company could share such information, the
21 Company cannot reliably track where these specific customers are located on the system.¹³¹
22 Instead, the Company utilizes its outage status recordings to inform all customers regarding the
23 status of system outages, thereby allowing customers to make informed decisions regarding their
24 unique, specific needs. But the Company cannot know whether every specific customer has
25 sufficient backup supply for a 1-hour versus a 4-hour outage. As Mr. Pignatelli stated during the
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27 ¹³⁰ See S-63 (Anderson Direct) at 19-20.

¹³¹ Ex. UNSE-22 (Ferry Rejoinder) at 6.

1 hearing, UNS Electric is happy to work with the appropriate agencies on this very important
2 issue.¹³²

3 **B. Citizens' Obligations and Projects.**

4 As suggested by Judge Wolfe during the hearing, UNS Electric contacted Mr. Magruder
5 and scheduled a meeting to discuss his concerns regarding the Citizens Settlement Agreement and
6 certain reliability issues. UNS Electric Vice President and General Manager, Mr. Thomas Ferry,
7 met with Mr. Magruder on October 16, 2007, in Tucson. While UNS Electric does not believe
8 that it has violated or neglected any terms of that agreement, UNS Electric continues to work with
9 Mr. Magruder to address his concerns.

10 UNS Electric briefly addresses two allegations Mr. Magruder makes in his Opening Brief.
11 First, Mr. Magruder states that "[e]ven though Mr. Pignatelli said seven scholarships have been
12 awarded, my School Board contacts in Santa Cruz County state NONE have been awarded in
13 compliance with this agreement."¹³³ Mr. Magruder's assertion has not been supported by any
14 reliable evidence presented before the close of the evidentiary hearing on October 2, 2007.
15 Regardless, Mr. Pignatelli was correct: UNS Electric has, in fact, awarded seven scholarships to
16 Nogales High School students from 1999 to 2003 through the Nogales Educational Foundation.
17 And, as Mr. Pignatelli stated at the hearing, UNS Electric will provide additional scholarships if
18 that was the agreement.¹³⁴ Even though additional scholarships were not agreed upon, UNS
19 Electric has nonetheless committed to fund additional scholarships not only for Nogales High
20 School students, but also for Rio Rico High School students, over the next four years.

21 Second, Mr. Magruder states, at page 20, lines 17-24 of his Opening Brief, that 20 above-
22 ground pole replacement projects, and 12 underground cable replacement projects, were not
23 completed as scheduled. Again, Mr. Magruder presented no evidence to this point, other than his
24 unsubstantiated and uncorroborated statements. He further cites to no agreement that specifically
25 requires completion of specific pole replacements that Mr. Magruder alleges need to be done. The

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27 ¹³² Tr. (Pignatelli) at 71-72.

¹³³ Magruder Opening Brief at page 19, lines 10-12.

¹³⁴ Tr. (Pignatelli) at 55.

1 settlement agreement approved in Decision No. 61793 (June 29, 1999) between UNS Electric's
2 predecessor and the City of Nogales contains no provision concerning pole replacements.¹³⁵ The
3 Company, in fact, developed a target of replacement projects; those projects were also researched
4 and engineered in detail. Those facilities in need of replacement were replaced. UNS Electric has
5 made numerous, significant reliability improvements in Santa Cruz County. Staff agrees that UNS
6 Electric is supplying customers with reliable service and that its capital construction program was
7 commensurate with a rapidly growing service territory.¹³⁶ No party supports Mr. Magruder's
8 unfounded assertions on this issue.

9 **C. Payday Loan Businesses.**

10 Mr. Magruder requests that the Company cease using "predatory" loan companies as
11 billing agents to accept cash payments from its customers. The Company endeavors to provide
12 convenient payment location options for all of its customers, and the Company believes that many
13 customers like having this option available to them. UNS Electric continues to work, however,
14 toward providing other locations where pay stations can be established.¹³⁷

15 **X. CONCLUSION**

16 UNS Electric respectfully requests that the Commission issue a final order granting it relief
17 as set forth in its Initial Post-Hearing Brief. UNS Electric has attached proposed findings of fact,
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19 ¹³⁵ Mr. Magruder's discussion of pole replacements spans from pages 30 through 35 of his Supplemental
20 Direct Testimony (admitted as Exhibit No. M-23). He cites to no order specifically requiring approval
21 of the projects he lists, nor is there any evidence provided justifying his alleged claim that these projects
22 had to be completed. Neither Decision No. 61793 (June 29, 1999) nor Decision No. 62011 (November
23 2, 1999) required replacement of the 20 specific projects he alleges need to be replaced. Further, Mr.
24 Magruder makes vague reference to a Citizens Supplemental Plan that was never attached to any of his
25 testimonies. The Company assumes he is referring to a May 7, 1999, plan that alludes to pole
26 replacements – which the Company attached as part of its February 9, 2004 filing in Docket No. E-
27 1032A-99-0401 concerning service quality issues in Santa Cruz County. Yet, the May 7, 1999
supplemental plan was not even mentioned, let alone required, per Decision Nos. 61793 or 62011.
Further, Mr. Magruder cites to no decision that approved the plan. In short, the Company had the
discretion to determine which, if any, pole replacements were needed given the circumstances that
existed at that time. Finally, the Commission determined in Decision No. 67151 (August 3, 2004)
addressed distribution reliability recommendations. Pole replacements were not mentioned in that
decision, although nine recommendations were approved by the Commission.


¹³⁶ Ex. S-55 (Taylor Direct) at 6-7. Mr. Taylor's Direct Testimony was adopted by Staff witness Prem
Bahl.

¹³⁷ Tr. (Ferry) at 517.

1 conclusions of law and ordering paragraphs as Attachment "A" to this Reply Brief that would
2 provide the Company the relief it is seeking in this case.

3 RESPECTFULLY SUBMITTED this 19th day of November 2007.

4 UNS Electric, Inc.

5
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By Mary Ippolito

ATTACHMENT

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2 Having considered the entire record herein and being fully advised in the premises, the Arizona
3 Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

4
5 1. UNS Electric is a public service corporation engaged in furnishing electricity in the
6 State of Arizona. UNS Electric provides retail electric service to customers in Mohave County and
7 Santa Cruz County.

8 2. On December 15, 2006, UNS Electric filed with the Commission an application for
9 an increase in rates and approval of financing.

10 3. On January 11, 2007, UNS Electric filed a supplement to its application.

11 4. On January 12, 2007, the Commission's Utilities Division Staff filed a Letter of
12 Sufficiency, notifying the Company that its application, as supplemented by the additional
13 information filed on January 11, 2007, met the sufficiency requirements and classifying UNS
14 Electric as a Class A utility.

15 5. On January 24, 2007, Staff filed a Request for Procedural Order, in which it
16 requested a hearing date of September 10, 2007, and associated procedural deadlines.

17 6. By Procedural Order dated February 1, 2007, procedural timeframes were established
18 and a hearing was scheduled to commence on September 10, 2007.

19 7. Intervention was granted to RUCO and Mr. Magruder.

20 8. UNS Electric filed Direct Testimony with its application on December 15, 2006.
21 Pursuant to Procedural Order dated January 12, 2007, Direct Testimony was filed on June 28,
22 2007 by Staff, RUCO and Mr. Magruder. Rate Design Direct Testimony was filed on July 12,
23 2007 by Staff, RUCO and Mr. Magruder.

24 9. UNS Electric filed Rebuttal Testimony on August 14, 2007. Staff, RUCO and Mr.
25 Magruder filed Surrebuttal Testimony on August 24, 2007. UNS Electric filed Rejoinder
26 Testimony on August 31, 2007.
27

1 10. The evidentiary hearing commenced as scheduled on September 10, 2007, at the
2 Commission's offices in Phoenix, and additional hearing days were held on September 11, 12, 13,
3 14, 20, 21 and October 2, 2007.

4 11. The Company filed Final Schedules on October 11, 2007. Staff filed Final Schedules
5 on October 16, 2007. RUCO filed Final Schedules on October 17, 2007.

6 12. Initial Post-Hearing Briefs were filed by UNS Electric, Staff, RUCO and Mr.
7 Magruder on November 5, 2007. All Parties filed Reply Briefs on November 19, 2007.

8 13. According to the Company's application, as modified, in the test year ended June 30,
9 2006, UNS Electric had adjusted operating income of \$8,770,016, on an adjusted Fair Value Rate
10 Base of \$177,847,579 for a 4.93 percent rate of return.

11 14. In its application, as modified, the Company requested a revenue increase of
12 \$8,468,638. Staff recommends a revenue increase of \$3,646,946. RUCO recommends a revenue
13 increase of \$1,189,270.

14 15. For purposes of this proceeding, we determine that UNS Electric has an Original Cost
15 Rate Base of \$141,036,562 and a Fair Value Rate Base of \$177,847,579.

16 16. The allowance of Construction Work in Progress ("CWIP") in rate base is a
17 regulatory tool available to the Commission to address high growth and related regulatory lag and
18 to protect a utility's financial integrity. Allowing CWIP in rate base can protect a utility's
19 financial integrity and preserve access to capital on reasonable terms.

20 17. Allowing approximately \$10.8 million in rate base for UNS Electric will add \$2.1
21 million annually in revenues to the Company that will improve the Company's cash flow and
22 allow it to protect its financial integrity. Protecting a utility's financial integrity is the determining
23 factor to decide whether CWIP should be allowed in rate base. Moreover, the majority of projects
24 were in-service as of June 30, 2007. Further, over half of the CWIP is for projects that are non-
25 revenue producing and non-expense reducing. Because the specific facts and circumstances in this
26 case support UNS Electric's need for such relief, UNS Electric is entitled to include \$10,761,154
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1 of CWIP in rate base.

2 18. In light of the short-term nature of the construction projects included in the test-year
3 balance of CWIP, it is appropriate for UNS Electric to continue accruing AFUDC on all eligible
4 construction projects with no offset required for the balance of CWIP included in rate base.

5 19. UNS Electric's depreciation study, submitted as part of Exhibit UNSE-32, as
6 amended by Staff's adjustment to correct an inadvertent omission to include a 10 percent net
7 salvage rate for UNS Electric transportation equipment, is reasonable and adopted herein.

8 20. Cost of capital is a function of the risk to which the capital is exposed.

9 21. A weighted average cost of capital of 9.89 percent is reasonable, based on an 11.80
10 percent return on equity, 8.22 percent cost of long-term debt, 6.36 percent cost of short-term debt,
11 and a capital structure consisting of 48.85 percent common equity, 47.18 percent long-term debt,
12 and 3.97 percent short-term debt.

13 22. An authorized return on equity for UNS Electric equaling 11.80 percent is reasonable
14 and is based on the Company's cost of common equity. UNS Electric is decidedly riskier than
15 other electric utility distribution companies mentioned on the record and the holding companies
16 used in the comparable company groups used by the witnesses to estimate cost of common equity.
17 The evidence in the record is that UNS Electric has a speculative-grade credit rating and a lack of
18 common dividend payment. UNS Electric also has all of its long-term debt maturing in August of
19 2008, and faces the need to replace its entire power supply portfolio upon termination of its full
20 requirements power supply contract on May 31, 2008.

21 23. An 11.80 percent return on equity should allow UNS Electric to attract capital on
22 reasonable terms, should ensure confidence in the financial soundness and integrity of the
23 Company, should be adequate, under efficient and economical management, to maintain and
24 support its credit and enable it to raise the money necessary for the proper discharge of its public
25 duties.

26 24. The Arizona Constitution and Arizona law require that fair value must be used to
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1 determine a fair rate of return.

2 25. Staff's proposed method to determine a fair value rate of return using its zero investor
3 supplied capital methodology does not meet the legal requirements to determine a fair rate of
4 return based on Fair Value Rate Base. Assigning a cost rate value of zero to the amount above
5 Original Cost Rate Base – or the amount Staff argued is not supplied by investor funds – does not
6 take into account the fair value of the Company's rate base.

7 26. RUCO's proposed method to determine a fair value rate of return through the
8 Commission's previous methodology also does not meet the legal requirements to determine a fair
9 rate of return based on Fair Value Rate Base.

10 27. The Company's proposal to apply 9.89 percent cost of capital to its Fair Value Rate
11 Base of \$177,847,599 is the only legally-permissible approach put forth in this case, although the
12 Commission is not bound to that approach. This would result in a required operating income of
13 \$17,592,000; however, because the Company commits to limiting its required rate increase request
14 to \$8,468,639, we will apply an overall rate of return on Fair Value Rate Base that takes this
15 limitation into account. Rate Base.

16 28. Based upon the evidence submitted, the Company's proposed allocation of revenue
17 requirement across customer classes is reasonable and is adopted herein.

18 29. The rates for customer classes should be set based on the Company's rate design
19 recommendation, with the customer charges for each class established at the level recommended
20 by the Company and with Energy and Base Power Supply charges also based on the revenue
21 requirement determined herein.

22 30. Mandatory TOU rates for new and moving residential, small general service
23 customers and large general service customers with maximum demand less than 1,000 kW, as well
24 as mandatory TOU rates for all large general service customers with greater than 1,000 kW
25 maximum demand is reasonable as it will encourage customers to reduce load from the system's
26 peak periods and is adopted herein. Further the Company's proposed TOU periods are
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1 appropriately designed and are also adopted herein. These TOU periods are: Summer On-peak
2 from 2:00 p.m. to 6:00 p.m.; Summer Shoulder from Noon to 2:00 p.m. and from 6:00 p.m. to
3 8:00 p.m.; Summer Off-peak from 8:00 p.m. to Noon; Winter On-peak from 6:00 a.m. to 10:00
4 a.m. and from 5:00 p.m. to 9:00 p.m.; and Winter Off-Peak from 10:00 a.m. to 5:00 p.m. and from
5 9:00 p.m. to 6:00 a.m.

6 31. The Company's proposed inverted-block (inclining block) rate structure for
7 residential and small general service customers will encourage conservation and is adopted herein.

8 32. The Company's proposal to consolidate rates for Mohave and Santa Cruz County
9 customers is appropriate because the systems are operating as one entity; therefore, the Company's
10 proposal as supported by RUCO is adopted herein.

11 33. The Company's purchase power allocation of 50 percent average and peaks and 50
12 percent energy properly accounts for the influence of load factor and is adopted herein. But
13 because the system load factor for UNS Electric is lower than TEP, using a purchased power
14 allocation for UNS Electric with a high percentage of energy is reasonable. Therefore, we will
15 order UNS Electric to use a purchased power allocation consisting of 60 percent energy and 40
16 percent demand (average and peaks) for its next general rate case.

17 34. For residential customers, the monthly customer charge should be increased from
18 \$6.50 to \$7.70; with a non-TOU energy charge for the first 400 kWh of \$0.013012 and an energy
19 charge for all additional kWhs of \$0.023012, and a residential base power supply charge of
20 \$0.073771. For TOU rates, the following energy rates should be: a summer on-peak of \$0.087961;
21 a summer shoulder of \$0.077581; a summer off-peak of \$0.072961; a winter on-peak of
22 \$0.076651; and a winter off-peak of \$0.061651.

23 35. The Company's proposal to change the CARES discounts to set monthly amounts of
24 \$8.00 for CARES customers and \$10.00 for Medical-CARES customers ensures that these
25 customers receive the maximum discount available to them and decouples usage from receipt of
26 the discount, is reasonable and is adopted herein.

1 36. Establishing a separate DSM Adjustor Mechanism for UNS Electric in this
2 proceeding is reasonable and is adopted herein. All DSM costs will now be recovered through this
3 DSM Adjustor Mechanism and not through base rates. The initial DSM Adjustor Rate will be
4 \$0.000583 per kWh and will remain in effect until June 1, 2009. This reflects 100 percent of UNS
5 Electric's LIW Program and 25 percent of its other DSM programs. In addition, it is reasonable to
6 require UNS Electric to file semi-annual reports for the DSM programs, for UNS Electric to make
7 its DSM Adjustor filing on April 1 of each year (starting in 2009), for an annual adjustment of
8 UNS Electric's DSM Adjustor on June 1 (starting in 2009). Full review of UNS Electric's DSM
9 Program Portfolio will take place in a separate docket (Docket No. E-04204A-07-0365, filed June
10 13, 2007).

11 37. UNS Electric's proposed change in Billing Terms to have 10 days before a
12 customers' bills are considered past due – along with an additional 15 days before a bill is
13 considered delinquent – is a reasonable modification that makes UNS Electric's billing terms
14 consistent with those for UNS Gas, avoids confusion for customers served by both UNS Gas and
15 UNS Electric, and is more lenient to the customer than what the Commission's rules allow and is
16 adopted herein. Under the Company's Billing Terms, customers will have 25 total days before a
17 bill is considered delinquent and before a late charge is rendered. Further, termination of service
18 then cannot occur until an additional five days elapse and only after notice of termination is given.

19 38. The Company's service line extension proposal – to reduce the service line extension
20 allowance by 50 feet and eliminating the free allowance for a carryover pole – is a reasonable
21 means of increasing the new customer contributions and is adopted herein.

22 39. The Company's Service Connection Contribution is an additional fee to be accounted
23 for as a non-refundable contribution in aid of construction to offset construction costs for new
24 electric service connections. A \$250 Service Connection Contribution for each new electric service
25 connection will reduce the future rate burden on existing customers due to system growth and is
26 adopted herein. We believe, however, that waiving the Service Connection Contribution is
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1 appropriate for those customers that build to UNS Electric's Energy Smart Homes efficiency
2 standards.

3 40. The existing Purchased Power and Fuel Adjustor Clause ("PPFAC") for UNS
4 Electric is not designed to address fuel and purchased power costs once UNS Electric's full
5 requirements power supply contract with Pinnacle West Capital Corporation expires on May 31,
6 2008.

7 41. The forward-looking or prospective PPFAC – as initially proposed by Staff and
8 endorsed by the Company – is the adjustor mechanism that will best ensure timely recovery of fuel
9 and purchased power costs. This new PPFAC will be more responsive to changes in fuel and
10 purchased power costs than the existing PPFAC.

11 42. The new PPFAC will take effect June 1, 2008, in accordance with the procedures
12 described in this Decision. The Forward Component and True-Up Component for the PPFAC Year
13 will be determined in accordance with the procedures described in this Decision. Any over-
14 collection in the existing PPFAC bank balance will be addressed through the True-Up Component.

15 43. The new PPFAC will not – at this time – contain a sharing mechanism or a cap, for
16 the reasons described herein.

17 44. The base power supply component for each class of customers proposed by the
18 Company in its Rebuttal Testimony is reasonable and appropriate. The initial base power supply
19 component for residential customers, for example, of \$0.073771 per kWh is reasonable and
20 appropriate.

21 45. The recoverable costs through the PPFAC will include Other Allowable Costs
22 identified by the Company in its proposed Plan of Administration, including credit costs, brokers
23 fees and legal fees directly associated with the procurement of fuel and purchased power.

24 46. The new PPFAC as proposed by Staff and endorsed by UNS Electric is adopted as
25 described herein.

26 47. Black Mountain Generation Station ("BMGS") will provide financial and operational
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1 benefits to UNS Electric and its customers if the Company owns the generation facility. Owning
2 BMGS will likely result in lower long-term costs due to the accumulated effects of depreciation
3 expense and deferred income taxes, thereby reducing the Company's revenue requirement relative
4 to a purchase power contract or long-term lease agreement. BMGS also will provide enhanced
5 reliability benefits, as well as flexibility of dispatch, operational control and a generating resource
6 close to its load center.

7 48. UNS Electric's request for a post-test-year adjustment of \$60 million to rate base
8 BMGS and for the related rate reclassification is reasonable.

9 49. The rate reclassification resulting from the post test year adjustment to rate base
10 related to BMGS would subtract approximately 0.6 cents per kWh from the base power supply rate
11 – including fuel and purchased power – and add approximately 0.6 cents per kWh into the base
12 delivery rate. Specifically, the base power supply rate for residential customers of \$0.073711 per
13 kWh would become \$0.067245 per kWh. The energy charge for the first 400 kWh would go from
14 \$0.013056 to \$0.019693 for residential charges – due to the change in the base delivery rate. The
15 energy charge for all additional kWhs would go from \$0.023056 to \$0.029693.

16 50. The BMGS rate base adjustment and the related rate reclassification will not occur
17 until UNS Electric shows BMGS to be in commercial operation. The Company will make a filing
18 – a project completion report – upon project completion and 30 days before implementing its
19 requested rate reclassification treatment. In no event will the rate base adjustment or rate
20 reclassification take place before June 1, 2008.

21 51. The Company commitment to limit the purchase price to the actual cost of
22 construction that UniSource Energy Development Corporation incurs is reasonable. If the actual
23 costs exceed \$60 million, then those additional costs will be the subject of the next rate case.

24 52. The recommendation to allow Staff and other parties will have the right to review and
25 evaluate the prudence of the construction costs for BMGS in the next rate case is reasonable.

26 53. In order to acquire BMGS, UNS Electric also seeks authority to issue up to \$40
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1 million in new debt securities in addition to any indebtedness arising out of transactions approved
2 in Decision No. 69395 (March 22, 2007). The Company further desires authority to issue up to \$40
3 million in either long-term debt and/or short- to intermediate-term debt with the authority to
4 refinance any short- or intermediate-term debt into long-term debt when the Company believes
5 market conditions are favorable to do so.

6 54. In connection with any debt issuance, UNS Electric seeks authority to grant a lien on
7 some or all of its properties – including the properties acquired with the proceeds of this financing
8 as well as properties acquired after the date the lien is granted – to secure its obligations under the
9 debt for which authorization is sought and to secure any other obligations of UNS Electric existing
10 at the time such lien is granted which need to be secured if such lien is granted.

11 55. The Company also seeks authority to receive up to \$40 million in additional equity,
12 in connection with the proposed acquisition of BMGS, to allow the Company to maintain a
13 balanced capital structure.

14 56. Staff recommends approving UNS Electric's request for approval of financing in its
15 rate application with the following conditions:

- 16 • That UNS Electric file a report with Docket Control demonstrating that the
17 Company had a DSC and a TIER ratio equal to or greater than 1.0 within 60 days
18 from the close of each new debt financing under this docket.
- 19 • That UNS Electric file a report with Docket Control – within 60 days from the
20 close of each financing package – describing the transaction and demonstrating that
21 the terms are consistent with those generally available to comparable entities.

22 57. Staff's conditions for approving the financing request are reasonable and we will
23 adopt them.

24 CONCLUSIONS OF LAW

25 1. UNS Electric, Inc. is a public service corporation within the meaning of the
26 Arizona Constitution, Article XV, and under A.R.S. Title 40, generally.

2. The Commission has jurisdiction over UNS Electric, Inc. and this proceeding.

3. Notice of the proceeding has been given in the manner prescribed by law.

4. The rates, charges, approvals and conditions of service established herein are just and reasonable and in the public interest.

5. As conditioned herein, the Company's request for financing of up to \$40 million in debt and up to \$40 million in equity approved herein is for lawful purposes within UNS Electric's corporate powers, is compatible with the public interest, with sound financial practices and with the proper performance by UNS Electric of service as a public service corporation, and will not impair the Company's ability to provide electric service.

6. The financing authority approved herein is for the purposes as stated in the application and at the hearing, is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or income.

ORDER

IT IS THEREFORE ORDERED that UNS Electric, Inc. is hereby authorized and directed to file with the Commission, on or before January 31, 2008, revised schedules of rates and charges consistent with the discussion herein and a proof of revenues showing that, based on the adjusted test-year level of sales, the revised rates will produce no more than the authorized increase in gross revenues.

IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service rendered on and after February 1, 2008.

IT IS FURTHER ORDERED that UNS Electric, Inc. shall notify its customers of the revised schedules of rates and charges authorized herein by means of an insert in its next regularly scheduled billing and by posting on its website, in a form approved by the Commission's Utilities Division Staff.

IT IS FURTHER ORDERED adopting the depreciation rates as proposed by the Company in its depreciation study and incorporating the correction from Staff.

1 IT IS FURTHER ORDERED that UNS Electric, Inc. shall use a purchased power
2 allocation consisting of 60 percent energy and 40 percent demand (average and peaks) for its next
3 general rate case.

4 IT IS FURTHER ORDERED establishing a DSM Adjustor Mechanism as described in this
5 order, with an initial rate of \$0.000583 per kWh.

6 IT IS FURTHER ORDERED that UNS Electric, Inc. shall make its DSM Adjustor filing
7 by April 1st of each year, starting in 2009.

8 IT IS FURTHER ORDERED that UNS Electric, Inc. shall file semi-annual reports for its
9 DSM programs in accordance with Staff's recommendations.

10 IT IS FURTHER ORDERED that UNS Electric, Inc. shall file, as a compliance item in this
11 Docket, the final conformed Plan of Administration for the Purchased Power and Fuel Adjustment
12 Clause consistent with this Decision, within 30 days of this Decision.

13 IT IS FURTHER ORDERED that upon acquisition of Black Mountain Generation Station,
14 UNS Electric, Inc. shall make a post-test-year adjustment to rate base of \$60 million as of June 1,
15 2008 or the date on which Black Mountain Generation Station is in commercial operation,
16 whichever is later.

17 IT IS FURTHER ORDERED that upon acquisition of Black Mountain Generation Station,
18 UNS Electric, Inc. shall reclassify its rates by reducing base power supply charge by approximately
19 0.6 cents per kWh and increasing the base delivery charge by approximately 0.6 cents per kWh,
20 depending on customer class, as of June 1, 2008 or the date on which Black Mountain Generation
21 Station is in commercial operation, whichever is later.

22 IT IS FURTHER ORDERED that UNS Electric, Inc. shall file a project completion report
23 30 days before rate basing Black Mountain Generation Station and making the rate reclassification.

24 IT IS FURTHER ORDERED that the acquisition cost of Black Mountain Generation
25 Station will be limited to the actual cost of completion to UniSource Energy Development
26 Company, and that any costs in excess of \$60 million shall be subject to further review and
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1 consideration in UNS Electric, Inc.'s subsequent rate case.

2 IT IS FURTHER ORDERED that Staff and other parties will have the right to review and
3 evaluate the prudence of the construction costs of the Black Mountain Generation Station in UNS
4 Electric, Inc.'s subsequent rate case.

5 IT IS FURTHER ORDERED that UNS Electric, Inc. is hereby authorized to issue up to
6 \$40 million in either long-term debt and/or short- to intermediate-term debt, for the purpose of
7 acquiring BMGS; and is further authorized to refinance any short- or intermediate-term debt into
8 long-term debt, without further order by the Commission, when the Company believes market
9 conditions are favorable to do so.

10 IT IS FURTHER ORDERED that UNS Electric, Inc. is hereby authorized to receive an
11 additional amount of up to \$40 million of equity for the purpose of acquiring Black Mountain
12 Generation Station.

13 IT IS FURTHER ORDERED that UNS Electric, Inc. is hereby authorized to grant a lien on
14 some or all of its properties – including the properties acquired with the proceeds of this financing
15 and properties acquired after the date of the grant of the lien – to secure the obligations under the
16 debt for which authorization is sought and to secure any other obligations of UNS Electric, Inc.
17 existing at the time such lien is grant which need to be secured if such lien is granted.

18 IT IS FURTHER ORDERED that UNS Electric, Inc. is hereby authorized to engage in
19 transactions and to execute or cause to be executed any documents or modifications to existing
20 transaction documents necessary to effectuate the authorizations requested from UNS Electric, Inc.
21 in connection with the financing of the BMGS purchase.

22 IT IS FURTHER ORDERED that UNS Electric, Inc. is hereby authorized to execute,
23 deliver, and perform all contracts, agreements and other instruments incidental to any or all of the
24 financing sought for Black Mountain Generation Station or otherwise deemed by UNS Electric,
25 Inc. to be necessary, desirable or appropriate in connection with this financing request.

IT IS FURTHER ORDERED that UNS Electric, Inc. file a report in this Docket demonstrating that the Company had a DSC and a TIER ratio greater than 1.0 within 60 days from the close of each new debt financing under this Docket.

IT IS FURTHER ORDERED that UNS Electric, Inc. file a report in this Docket, within 60 days from the close of each financing package, describing the transaction and demonstrating that the terms are consistent with those generally available to comparable entities.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, DEAN S. MILLER, Interim Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this ____ day of ____, 2007.

DEAN S. MILLER
INTERIM EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____